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IMPACT OF THE LATIN AMERICAN DEBT CRISIS ON THE UNITED STATES

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL DEBT

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

MARCH 9, 1987

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IMPACT OF THE LATIN AMERICAN DEBT CRISIS ON THE UNITED STATES

MONDAY, MARCH 9, 1987

U.S. Senate,
Subcommittee on International Debt,
Committee on Finance,
Washington, DC.

The committee was convened, pursuant to notice, at 9:30 a.m. in room SD–215, Dirksen Senate Office Building, the Honorable Bill Bradley (chairman) presiding.

Present: Senators Bradley, Rockefeller, and Danforth.

[The press release announcing the hearing and the prepared statements of Senators Bradley and Durenberger follow:]

[Press Release No. H-21]

International Debt Subcommittee Chairman Bradley Announces Hearing on the Impact of the Latin American Debt Crisis on the United States

Washington, DC.—Senator Bill Bradley (D., New Jersey), Chairman of the Finance Committee's Subcommittee on International Debt, announced Monday that the Subcommittee will hold a hearing on *Monday, March 9, 1987, at 9:30 a.m. in Room SD-215 of the Dirksen Senate Office Building,* to assess the impact of the Latin American debt crisis on U.S. manufacturing jobs, U.S. farms, U.S. non-financial businesses, Latin American standards of living, and inter-American security. The hearing should help determine the extent to which Latin American debt burdens, and the policies adopted to deal with those burdens, have exacerbated U.S. joblessness, the U.S. trade deficit, and Latin American recession.

Bill Bradley
U.S. SENATOR
Democrat/New Jersey
731 Hart Senate Office Building • Washington, D.C. 20510 • 202/224-3224

OPENING STATEMENT BY SENATOR BILL BRADLEY
SUBCOMMITTEE ON INTERNATIONAL DEBT, FINANCE COMMITTEE
March 9, 1987

Let's say you run a hardware store in Fairmont, Minnesota. Most of your customers are farmers. What will happen to your business as the farm credit crisis deepens? If your customers use more and more of their earnings just to pay the interest on their loans, they are going to cut purchases in your store. You'll be lucky to stay in business.

The farm credit crisis hurts both farmers and their suppliers. But at least Congress and the Administration recognize it as a national problem. Today we will explore a problem that poses as big a threat to our national well being--the impact of the Latin American debt crisis on Americans.

The U.S. is similar to the hardware store in Fairmont. And Latin America is the customer in deep trouble. The nations of Latin America are our natural growth partners; they are our neighbors. One of the hopes we have for our children to enjoy the same kind of economic growth we had after World War II is to help those neighbors prosper. Prosperous customers make for a prosperous store.

In the two years after Mexico nearly defaulted in 1982, sales of U.S. construction equipment to Latin America plummeted. A New Jersey pharmaceutical company told me that its Ecuador branch can no longer buy materials from its New Jersey plants. Ecuador uses all the dollars it accumulates every year just to pay interest on its debt and to buy absolute necessities. We may hear a similar story today from the U.S. farm sector.

The numbers have the dry ring of an obituary. In two years, between 1981 and 1983, machinery exports to Latin America dropped 38%, steel and motor vehicles dropped 50%, construction equipment dropped 80%, and agricultural machinery dropped 86%. U.S. exports have never recovered.

No exports mean no sales. No sales mean no jobs. In fact, 400,000 Americans have lost their jobs because the Latin American export market dried up and another 400,000 Americans didn't get jobs because Latin American economies stopped growing.

If the debt crisis has hit us this hard, what has happened to our neighbors to the south?

The debtor nations owe so much money to U.S. banks that in order to pay it back, they are siphoning off funds that they need to improve their own living standards. During the 1980's, living standards have dropped 8% in Mexico, 14% in Peru, 17% in Argentina, and 19% in Venezuela. At the same time, the region has transferred $100 billion to foreign banks in the last four years. People are out of work and losing hope.

The solution to the debt crisis proposed by the Administration and the major banks is new additional loans on top of the other loans that the Third World countries can't afford to pay in the first place. It doesn't make sense. If you miss a payment on your credit card, what bank responds by increasing your credit line? It sounds preposterous! But that has been the preferred way to handle Third World loans. When an indebted country can't make a debt payment, banks provide fresh loans to cover the shortfall. The country is left with higher debt, no new productive assets, and the same old shortfall.

The danger for creditors is that emergency loans let banks treat bad loans as if they were good. Shareholders don't really know where they stand. Eventually banks' books lose touch with reality and the danger of default increases. The greater danger, of course, is the destabilization of the world's financial system and the ensuing economic chaos.

It is also dangerously naive to deny the political nature of the debt issue. Brazil now is a democracy. The new democracies of Latin America and the Philippines have replaced military governments that lived on irresponsible debt financing and inflation. The efforts of these young democracies to stay current on the debts of their predecessors have thrown many into recession and crippled their ability to combat poverty. The ability of these new democracies to survive is largely dependent on their ability to fight poverty while managing their debt. Third World debt has created a referendum on whether democracy can combat poverty.

I have believed for several years that offering managed debt relief is simply a necessity if the world's economy is to keep growing. The alternative is a deepening crisis that causes hundreds of thousands of Americans to lose their jobs. In international finance, there is only mutual growth or mutual contraction. Managed debt relief for Third World democracies can protect American jobs, open up more foreign markets to American goods, fight poverty in Latin America, and sustain the growth of democracy in the Third World. It is a reasonable price to pay given these important goals.

I want to thank all of you for testifying here today and for your concern about the debt crisis. Many of you have made sacrifices to appear here; some have come great distances. I think that alone testifies to the importance of the issue. We will seek to discover how the debt crisis and the policies adopted to deal with it affect the lives of North, Central, and South Americans alike. Congress and the Administration cannot afford to put the boiling mixture of debt, trade, joblessness, and poverty on the back burner any longer.

STATEMENT OF SENATOR DAVE DURENBERGER
SUBCOMMITTEE ON INTERNATIONAL DEBT
MARCH 9, 1987

Mr. Chairman, I want to commend you for scheduling this hearing and for your leadership in raising the level of public debate on the critical issue of the impact of the Latin American debt crisis on the American economy.

I have long supported the idea of encouraging commercial banks to write down and forgive some of the $377 billion in loans currently outstanding in Latin America. If this approach were adopted, I believe we would improve political and economic stability in our hemisphere, while improving the economic prospects of American business, especially our hard-pressed farmers.

There can be no doubt but that the Latin American debt crisis has significantly damaged our rural economy and driven many of our farmers into bankruptcy. The crisis in rural America results from the simple fact that agriculture supply far exceeds demand worldwide. And one of the main reasons for the excess of worldwide supply is that the debt crisis in Latin America has forced Latin governments to implement policies that encourage their farmers to produce commodities for export.

Mr. Chairman, the hard fact of the matter is that interest and principle on Latin American debts owed to American banks must be repaid in dollars. Brazil can't repay these loans by printing more cruzeros; Mexico can't repay its debts in pesos. All of the Latin debtors must earn hard currency--dollars, yen or marks--to repay these loans.

With this fact as a given, Latin America has become a key player in the worldwide export market, while at the same time it has sharply cut back imports of products that must be paid for in hard currency.

At the same time, the depression that has pervaded rural America throughout this decade is clearly traceable to the shrinking of export markets for our agricultural products and intensified competition from abroad for a larger and larger share of the American consumer's food dollar.

In 1981, Latin America imported more than $119 billion worth of goods and commodities. Latin America was the third largest market for our agricultural commodities and, along with other developing nations, was predicted to be the biggest future market for our agricultural exports.

By 1985, Latin America barely imported $50 billion worth of products and ran a trade surplus with the United States in the neighborhood of $20 billion. Moreover, during the period 1981-86, U.S. agricultural exports to Latin America declined nearly 50 percent.

It is not just the shrinkage in farm exports to Latin America that has hurt our farmers. The worldwide commodity glut that has devasted all farmers is directly related to the aggressive export promotion policies of Latin American countries under the gun from American banks to earn hard currency to meet their debt payments.

Argentina and Brazil have become direct competitors with American farmers for export sales of wheat, soybeans, orange juice and other agricultural commodities. In the 1980s, U.S. soybean exports fell by 36 percent. At the same time, Brazilian soybean exports quadrupled and Argentina's doubled. .In fact, Argentina claimed 80 percent of the worldwide markets lost by U.S. soybean growers!

Latin Americans are also becoming a growing factor in the U.S. market, further pressuring our domestic producers. Pillsbury's Burger King produces 6 million pounds of beef in Costa Rica--enough to satisfy 2 percent of its American hamburger needs. Just about all of the beef in Campbell chunky soups comes from its beef processing plant in Argentina.

It's not just beef imports that have turned America from being the world's dominant food exporter into the second largest food importer behind West Germany. Half the concentrate used in the nation's frozen and chilled orange juice comes from Brazil. Grapes from Chile account for 22 percent of the domestic market and fruit and vegetable growers from Latin America are decimating American growers.

It is ironic that despite the aggressive export push of Latin American countries, the debt crisis refuses to abate. Just two weeks ago, Latin America's biggest debtor, Brazil, suspended interest payments on its $108 billion debt. Ecuador recently missed one of its scheduled interest payments while Peru, for the past two years, has ignored the demands of its bank creditors and limited interest payments to a percentage of its exports.

After five years of endless rescheduling of Latin American debt, I believe the major Latin American creditor banks must face the fact that the time for loan forgiveness is at hand. The current policy of requiring the Latin Americans to pay every dime of debt owed has failed. And the victims of this failed policy are not just the citizens of Latin America who have seen their standard of living decline precipitously, but the American farmer and the citizens of communities in rural America.

While the nine money center banks who face the greatest lending exposure in Latin America recorded nearly $12 billion in profits and declared nearly $6 billion in dividends in the years 1982 through 1985, small rural American banks have been closing at rates not seen since the 1930s Depression.

In 1982, there were 42 bank failures in America. By 1985, bank failures jumped to 116. In the year just past, 138 insolvent banks were liquidated or merged into healthier institutions. And in the first two months of 1987, small banks have been closing at a rate of more than two a day. Nearly all of these banks were rural banks that could no longer survive the farm depression of the 1980s.

For the last several years, we in Washington have been aggressively encouraging Middle West bankers to write down their bad farm loans. The same approach is now required for the large money center banks with regard to their Latin American loans. All of the bankers know that these loans will never be repaid and this fact is reflected in the secondary market where banks sell and swap their Latin American debt.

Latin American loans trade at extraordinary discounts in the secondary market. Argentine loans are discounted 34%; Mexican loans trade at a discount of 43%, and if you can find a buyer, Bolivian loans trade at a 93% discount.

A policy of loan forgiveness and debt restructuring is eminently sensible. Once the Latin American countries are freed from the demand to repay all of the interest on their debt, the money that would have gone to pay interest will be rechanneled into domestic investments that aim at improving the standards of living in these countries.

The ultimate beneficiaries of expanded standards of living in the third world will be American companies that need export markets to grow and expand. At the same time, the rural economy of America will benefit because our farmers will no longer have to compete with subsidized Latin American farmers who must sacrifice sales in their domestic markets in order to earn foreign currency to service their debt.

Senator **Bradley**. The hearing will come to order. This is a hearing of the Subcommittee on International Debt, and today's hearing deals with the issue of Third World debt and its impact on the United States.

Let's say that you run a hardware store in Fairmont, Minnesota, and most of your customers are farmers. What will happen to your business as the farm credit crisis deepens? If your customers use more and more of their earnings just to pay the interest on their loans, they are going to cut purchases in your store, and you will be lucky to stay in business. The farm credit crisis hurts farmers and their suppliers, no question about it; but at least Congress and the Administration recognize that it is a national problem.

Today, we will explore a problem that is as big a threat to our national well-being—that is the impact of the Latin American debt crisis on Americans.

The U.S. is similar to the hardware store in Fairmont, and Latin America is the customer in deep trouble. The nations of Latin American are our natural growth partners; they are our neighbors. One of the hopes we have for our children to enjoy the same kind of economic growth as we had after World War II is to help those neighbors prosper. Prosperous customers make for a prosperous store.

But in the two years after Mexico nearly defaulted in 1982, sales of U.S. construction equipment to Latin America plummetted. Machinery exports to Latin America dropped 38 percent; steel and motor vehicles dropped 50 percent; construction equipment dropped 80 percent; agricultural machinery dropped 86 percent. The fact is that U.S. exports have never recovered. No exports means no sales; no sales means no jobs.

In fact, 400,000 Americans have lost their jobs because of the Latin American export market drying up, and another 400,000 didn't get jobs because the Latin American economy stopped growing. If the debt crisis, therefore, has hit us hard, what has happened to our neighbors to the south?

The debtor nations owe so much money to U.S. banks that, in order to pay it back, they are siphoning off funds they need to improve their own living standards. During the 1980s, living standards have dropped across the board in Latin America. At the same time, the region has transferred $100 billion to foreign banks in the last four years. People are out of work and losing hope.

The solution to the debt crisis proposed by the Administration and the major banks is new additional loans on top of the other loans that Third World countries can't afford to pay in the first place. This doesn't make sense.

If you miss a payment on your credit card, what bank responds by increasing your credit line? It sounds preposterous, but that has been the preferred way to handle the Third World debt crisis. When an indebted country can't make debt payments, banks provide fresh loans to cover the shortfall. The country is left with higher debt, no new productive assets, and the same old shortfall. The danger for creditors is that emergency loans let banks treat bad loans as if they were good; shareholders don't really know where they stand.

Eventually, banks' books lose touch with reality, and the danger of default increases. The greater danger, of course, is the destabilization of the world's financial system and the ensuing economic chaos.

It is also dangerously naive to deny the political nature of the debt issue. Brazil is now a democracy. The new democracies of Latin America and the Philippines have replaced military governments that lived on irresponsible debt financing and inflation. The efforts of these young democracies to stay current on the debts of their predecessors have thrown many into recession and crippled their ability to combat poverty. The ability of these new democracies to survive is largely dependent on their ability to fight poverty while managing their debt.

Third World debt has created a referendum on whether democracy can combat poverty. I believed for several years that offering managed debt relief and interest rate relief is simply a necessity if the world's economy is to keep growing. The alternative is a deepening crisis that causes hundreds of thousands of Americans to lose their jobs. In international finance, there is only mutual growth or mutual contraction. Managed debt relief for Third World democracies can protect American jobs, open up foreign markets to American goods, fight poverty in Latin America, and sustain the growth of democracy in the Third World. It is a reasonable price to pay, given these important goals.

I want to thank all those of you have come to testify today for your concern about the debt crisis. Many of you have made sacrifices to appear here. Some of you have come from great distances. I think that alone testifies to the importance of this issue. Today, we will seek to discover how the debt crisis and the policies adopted to deal with it affect the lives of people living in North America, Central America, and South America.

The focus of today's hearing is on how the debt crisis has affected people's lives. Congress and the Administration cannot afford to put the boiling mixture of debt, trade, joblessness, and poverty on the back burner any longer.

It is my hope that these hearings will focus the issue for people who haven't quite been able to get it in focus, emphasize the issue for those who have been interested, and over the course of the next five months, set an action program for those who want to solve the crisis.

Senator Rockefeller, do you have an opening statement?

Senator Rockefeller. No, Mr. Chairman.

Senator Bradley. I would place in the record Senator Durenberger's opening statement. Our first panel consists of four people. First, we have Roberto Santiago, who will be speaking for the General Confederation of Labor, who is here today instead of Joaquim dos Santo Andrade, who was supposed to be here but couldn't at the last minute get out of the hospital. Next, the Reverend Thomas Burns, a missionary at Padres de Maryknoll in Lima, Peru; The Honorable Sally Shelton-Colby, a consultant with Bankers' Trust; and Richard E. Feinberg, Vice President, Overseas Development Council.

I would like to welcome you. The way we would like to proceed is that each of you have your testimony, and it will be submitted to

the record in full. I would like you to take five minutes and summarize or highlight your testimony so that we might have the maximum amount of time for questions and answers and discussion.

The record we will make today will be available to the entire Finance Committee and to the entire Senate, and I thank you very much for coming. Why don't we begin with Mr. Santiago? I understand that Mr. Santiago speaks only Portuguese, so we will begin by having him present his views; and we will have a translator who will convey those views to the committee. Mr. Santiago, welcome to the Finance Committee of the United States Senate, and we look forward to hearing your views.

And I hope that you don't mind our trying to keep it within the five to six minute limit for testimony length. That is a custom in the Finance Committee. If we didn't have that, people would talk as long as Senators talk. [Laughter.]

STATEMENT OF ROBERTO SANTIAGO, PRESIDENT, GENERAL CONFEDERATION OF WORKERS, SAO PAULO, BRAZIL, ACCOMPANIED BY SYLVIE LOPES, WASHINGTON, DC

[Whereupon, Mr. Santiago delivered his statement through an interpreter, Ms. Sylvie Lopes.]

Mr. SANTIAGO. We would like to thank Senator Bradley for this opportunity to speak to the American Senate. Thank you.

On behalf of CGT, the Central Unit of Workers in Brazil, and on behalf of our Chairman, Mr. Joaquin dos Santo Andrade, we would like to thank the AFL-CIO for giving us all the support to participate in this discussion.

In the economic history of Brazil and most of the countries of Latin America, the 1980s will be known as a lost decade from the economic development point of view. The long recession, high levels of unemployment, and underemployment, unprecedented high inflation rates, decreasing levels of salaries in real terms, the real misery and poverty for the majority of the population depict a social and economic regression which causes a serious negative impact on these countries' political development.

Deterioration of the economic performance was caused greatly by adverse evolution of the international scenario which translated into a significant reversal of financial flows. As a result, Latin American economies were forced to become exporters of real resources and to surrender significant amounts of their wealth. The latest years show that the Brazilian economy with its many problems would hardly be able to afford massive transfer of resources without economic, political, and social costs.

In addition, during this period in Brazil, the economic output has been higher than domestic consumption, with a balance for responding to net transferences on account of foreign debt servicing. In the last two years, these payments absorbed more than five percent of the GNP and 40 percent of the export of goods and services.

Considering a longer period of time, Brazil already paid in interest rates $153 billion in the last 17 years, and its total debt has grown in that same period from $53 billion in 1970 to $108 billion. There shouldn't be any doubt that such huge transfer payments restrains the development of a country for the following reasons.

First, it restricts the capacity to strengthen the country's economy which needs high growth rates and modernization of its industries. Second, it limits the growth of the domestic markets, thus hindering the task of economic growth with price stability. Third, it worsens the public sector's finances. The public sector holds 80 percent of Brazil's foreign debt. In order to finance the fiscal deficit, the public debt constantly increases, thus crowding out private sector investment projects.

Fourth, it dramatically reduces the availability of resources for investments, thus adversely affecting potential economic growth in the immediate and long run. Last, but not least, the above obstacles severely interfere with the implementation of policies which would improve the miserable conditions affecting a great part of the population, thus making it impossible to honor the obligation of the country's social debt, a major hindrance in the consolidation of democracy.

Presently, our country is being pressured by the international financial community to renegotiate with the IMF. This is unacceptable to the Brazilian people, because the IMF, by strongly recommending severe economic measures inflicts hunger and misery in debtor nations, which jeopardizes the consolidation of democracy in our country.

The IMF ignores the profound changes in the international financial system that contributed to increase in real interest rates to 6.5 percent in the last six years.

Brazil's development was adversely affected since most of its debt had been incurred between 1960 and 1980, when the real interest was around 1.7 percent. The IMF also ignored the commission fees charged by banks doing the refinancing process. Just to illustrate the burden caused by the foreign debt, in the last four years Brazil paid $48 billion just in interest payments, having received only $11 billion in new loans for the same period of time.

The workers did not have a voice or any representation in the process of contracting new loans. The commercial banks loaned to developing countries huge amounts of money in unconditional terms. A typical example was the construction of nuclear power plants when a great deal of our people was starving and living in abject poverty.

On the other hand, as far as capital flight is concerned, it has reached unprecedented levels in Latin America. And we don't anticipate any IMF actions to pressure the international banks in order for these banks to reject deposits that clearly constitutes capital flight.

The CGT Workers Central Union, along with the entire Brazilian trade union movement, always took part in discussions of the country's foreign debts, according to Congress' resolutions in trade union meetings and the historical general strikes on July 21, 1983 and December 12, 1985. The CGT understands that it is impossible to honor the country's social debt, as well as to provide for decent living conditions for its workers and ensure development, if the working class has to bear the costs.

Each transferred dollar in payment of this debt represents a starving child, a jobless worker, a youth with no education. Accepting the current terms of our foreign debt means that the country could lose its sovereignty and the control of its economy and would be at the mercy of the international bankers and the multinational corporations.

For all these reasons, the Brazilian CGT agrees with the halting of payments of its foreign debt until the nation reaffirms its sovereignty. It should never be enough to stress that we are in the process of consolidating our democracy, and no democracy can survive hunger, misery, poor education, poor health, and lack of housing.

It is our understanding that should these current terms persist, there will be no possibility whatsoever for us to honor our foreign debts. The solution for such a serious problem will then only be found through political action among democratic nations. Thank you very much.

Senator **Bradley**. Thank you very much, Mr. Santiago, for your testimony. We will hear all of the witnesses and then have questions. Reverend Burns? Welcome to the committee, and just tell us your story.

[The prepared written statement of Mr. Santiago follows:]

[illegible] of Sao Paulo, [illegible], as a witness before the Senate Finance Committee's Subcommittee on International Debt hearing on Monday, March 9, 1987 at 9:30 A.M.

*CGT (CONFEDERACAO GERAL DOS TRABALHADORES ... General Confederation of Workers) of Brazil

In the economic history of Brazil and most of the countries of Latin America - the 80's will be known as a lost decade from the economic development point of view; prolonged recession, high levels of unemployment and underemployment, unprecedented high inflation rates, decreasing levels of salaries in real terms, deterioration of poverty and misery for the majority of the population depict a social and economic regression which causes a serious negative impact on these countries' political development.

Deterioration of the economic performance was caused greatly by adverse evolution of the international scenario which translated into a significant reversal of financial flows.

As a result, Latin American economies were forced to become exporters of real resources and to surrender significant amounts of their wealth, as well as an increased proportion of their gross national product.

The latest years showed that the Brazilian economy, with its many problems, would hardly be able to afford massive transfer of resources without economic, political and social costs. In addition, during this period, in Brazil the economic output has been higher than domestic consumption and investment with a balance corresponding to net transferences on account of foreign debt servicing. In the last two years, these payments absorbed more than 5% of the GNP and 40% of the exports of goods and services. Considering a broader period of time, Brazil already paid in interest rates 153 billion dollars in the last 17 years, and its total debt has grown in that same period from 5.3 billion dollars in 1970 to 108 billion dollars.

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Last, but not least, the above obstacles severely interfere with the implementation of policies which would improve the miserable conditions affecting a great part of the population, thus making it impossible to honor the obligations of the country's social debt - a major hindrance in the consolidation of democracy.

Presently, our country is being pressured by the international financial community to renegotiate with the IMF. This is unacceptable to the Brazilian people because the IMF by strongly recommending severe economic measures inflicts hunger and misery in debtor nations, which jeopardizes the consolidation of democracy.

The IMF ignores the profound changes in the international financial system that contributed to increases in real interest rates to 6.5% in the last six years. Brazil's development was adversely affected since most of its debt had been incurred between 1960 and 1980, when the real interest rate was around 1.7%.

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It should never be enough to stress that we are in a process of consolidating our democracy, and no democracy can survive hunger, misery, poor education, poor health, lack of housing. It is our understanding that should these current terms persist, there will be no possibility whatsoever for us to honor our foreign debt. The solution for such a serious problem will then only be found through political action among democratic nations.

STATEMENT OF THE REVEREND THOMAS BURNS, MISSIONARY, PADRES DE MARYKNOLL, LIMA, PERU

Reverend BURNS. Thank you very much, Senator Bradley.

Before beginning my testimony, I would like to express my gratitude to you, Mr. Chairman, for your invitation to address this distinguished body. I am appearing here this morning on behalf of Interfaith Action for Economic Justice, a coalition of 29 Protestant, Jewish, and Roman Catholic organizations that advocate for government policies to improve the quality of the life of the poor. I belong to Maryknoll, a Roman Catholic missionary society. I wish to speak from my experience of 17 years in Peru as a missionary priest working among the poor, four years in the Altiplano of Peru on the shores of Lake Titicaca, and the last 13 years in an urban slum parish south of Lima, 15 miles from downtown.

My parish is one of 150,000 people, all poor; and I wish to speak to the effects of the debt on their lives. It was first brought to my attention—the relationship between the debt and the effects of the lives of the poor—by Maria Cispe, who came to me, the third woman that day, with her son dying in her arms to be baptized. It was the summer of 1979— February in Peru is the summer. We priests in the parish, took an informal tab of the infant baptisms in that month and it turned out to be an average of three a day.

And looking into the "why" of this, we began to see the relationship of pain—the debt—the dehydration, malnutrition, et cetera.

I would not like to get into right now all the policies of development and who is responsible. Time doesn't allow for that. I would say, first of all, that all are responsible except the poor. The International Monetary Fund policies, at the behest of the banks for their payments, aimed at reducing internal consumption and reorienting towards export. There are other things relating to that, but these have a direct effect on the lives of the poor.

And I would like to go into that—what these policies have meant in the attempts to pay the debt. These policies have meant destabilization for the banks, to a certain extent, and certain segments of people in Peru in the upper classes. It has meant starvation for my parishioners and for the poor in general in Peru.

Between 1975 and 1985, the percentage of workers fully employed was reduced from 50 percent of the work force to 35 percent, while underemployment grew from 42 to 53 percent, and unemployment from 8 to 12 percent. During the same period of time, the buying power of the people—the working person with full-time stable employment—was reduced 60 percent.

Consequently, this meant that the principal breadwinner of a family of six in 1975 had to feed nine people in 1985 with 60 percent less income. Even more concretely, this means a person earning the minimum wage of 920,000 solares a month in Peru for 40 to 48 hours work a week can buy one pound of sugar, a quarter pound of bread, one pound of chicken, a few ounces of coffee daily to pay four bus fares and, at the end of the month, will owe 10,000 solares. This budget is for a family of six.

I hasten to add that 65 percent of the work force in Peru does not earn the minimum wage. Is it any wonder that 40 percent of the children in Peru suffer serious malnutrition? Is it a surprise that, while I heard of one or two cases of tuberculosis in my parish in 1975, by 1985 the one or two cases was a year was one or two cases a day.

There are 15 soup kitchens in my parish at this point. In 1975 there were none. Fifty percent of the deaths in Peru are children under five years of age. The Peruvian bishops estimated the cost of the debt at 20,000 children dying a year, in terms of increases in infant mortality.

To be poor today in Peru is to expect to suffer from TB or typhoid. It is endemic; it is not epidemic.

I would like to go into also the social costs of these policies. A great patriot said a few hundred years ago: "Taxation without representation is tyranny." It was Patrick Henry and, because of his efforts, democracy exists. The poor in Peru have tried to urge a democracy and create a democracy out of their struggles for the last 10 years.

The military government gave way to a democratic government in 1980. The democratic government is continuing the same economic policies which caused the starvation and caused these effects. The people went back to the polls and replaced that government with another democratic government. The people have struggled to construct soup kitchens, struggled to participate in the community on all levels to create democracy.

At the same time, there are elements within the nation—fanatical terrorists—who wish to overthrow the present government and the democratic system because they feel that they will not respond to the poor. It has been a violent response and the situation of debt payment has contributed—if not caused that violent response—to fertile ground for recruitment. Families have been destroyed. Youth have graduated for the last five years into frustration and joblessness. Violence threatens the very fabric of a peaceful people, of a nation which has been known for its activity among the people.

I would like to address the question at this point of the ethics involved. I would like to quote Archbishop Rembert Weakland in his testimony before a House committee a few days ago: "This is not a question of simply economics. It is also a question of ethics. It is not a question of material welfare. It is also morality." Archbishop Rembert Weakland says "The third argument of the Archbishop's pastoral letter is that all members of society have a special obligation to the poor and the disadvantaged." For us, the ultimate test of justice is how economic policy choices affect the poor.

I have addressed this issue under a pseudonym in an update in the New York Times in August of 1979. I have talked before the House committee in February of 1979, the Senate Foreign Relations Committee in March of 1979. I returned home to find a neighbor named Felicita whose two brothers died of TB within two years. She is crippled with polio, 22 years of age, has four younger brothers and sisters. I came back in 1983 and gave testimony before another House committee. I returned to find Felicita's mother had died of TB. She buried her father last August of TB. She has four younger brothers and sisters who are orphans. They are my neighbors. She is their sole support.

My question before this body is: What will I return to say to Felicita at this time? Are her younger brothers and sisters to become victims of TB? Are her neighbors to become victims of jobless futures? Are the youth of Peru to be members, as one person said, to have the choices in life of being "ratero, cocalero, or Sendero," which means a thief, a cocaine dealer or a Senderista? That is what I would like to know.

There are several detailed recommendations in the body of our paper. Thank you very much.

Senator **Bradley**. Thank you very much, Reverend Burns. Now, the Honorable Sally Shelton-Colby. Welcome to the committee, and we look forward to your thoughts.

[The prepared written statement of Reverend Burns follows:]

Interfaith Action for Economic Justice

Members of **Interfaith Action for Economic Justice** are the mission boards or program units of national religious agencies working together for just and effective US food and agriculture, health and human services, and development and economic policies.

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Interfaith Action for Economic Justice, continuing the work of the Interreligious Taskforce on US Food Policy, speaks for itself and not its member agencies.

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Statement by

REV. THOMAS J. BURNS, M.M.

on behalf of
Interfaith Action for Economic Justice

before the
Subcommittee on International Debt
of the
Committee on Finance
U.S. Senate

March 9, 1987

My name is Tom Burns. I am a Maryknoll priest serving poor people in Peru. I've spent the last seventeen years as a missionary in Latin America living and working among the poorest segments of the population, rural and urban. I am appearing before this subcommittee this morning on behalf of Interfaith Action for Economic Justice, a coalition of 29 Protestant, Roman Catholic, and Jewish organizations that advocate for government policies and programs to improve the quality of life of poor people.

My organization, Maryknoll Fathers and Brothers, is a member of Interfaith Action. Here in Washington, both the coalition and its member agencies have become increasingly alarmed about the human costs of the debt crisis; they welcome your attention to this important issue. However, what I have to say this morning reflects mainly my personal experience and does not, therefore, necessarily represent the views of Interfaith Action or its member organizations.

I greatly appreciate this opportunity to address a few remarks to you as you continue your deliberations on the crucial subject of Third World debt. The World Bank estimates that the total of that debt now exceeds $1 trillion. What I intend to focus on is not that mind-boggling figure but the concrete ways that this debt injures people who have had nothing to do with accumulating it, but who nevertheless bear disproportionately the impact of the remedial measures instituted by their governments.

A Question of Justice

Until recently, the debt crisis was viewed as a purely financial problem. The political dimensions of the crisis are now also being acknowledged. Beyond these considerations, however, lie profoundly moral issues, because the money and politics translate ultimately into human suffering. Justice for the poor, and honorable peace for us all, lie at the heart of the debt crisis, with the lives of millions at stake. Interfaith Action for Economic Justice recognizes not only the basic human rights of access to food, shelter, health care, education and employment but also the right of nations to economic independence and political self-determination. Finally, human stewardship requires that the world's natural resources be used to benefit all the world's people in this and all future generations. They must not be squandered in satisfying mere short-term interests.

The relationship between ethics and economics is either simple or complex, depending on whose analysis and definitions are used. In the current debt crisis debate, one hears endless debates about who is "responsible" -- the lending countries and banks or the borrowing countries. Whether the blame lies more on one or another group of actors is not the question we are addressing here. Rather we can and do affirm that the poor are not responsible but are bearing the brunt of the debt payment adjustments.

"Responsibility" relates not merely to blame but knowledge: knowing that millions of poor people are suffering, even dying, as a result of the debt crisis. To quote Javier Iguiniz, a prominent Peruvian economist and Catholic scholar, "The temptation for all of us is to evade the moral responsibility which comes from the mere knowledge that the needy exist, resorting to explanations of the situation that make it easy to 'wash our hands' and transfer the problem to others."

Debt and Development -- Losing Ground

Available studies of the international debt crisis almost exclusively assess the impact on commercial banks, First World, and Third World governments, and international financial institutions such as the World Bank and the International Monetary Fund (IMF). A forthcoming UNICEF study, titled "Adjustment with a Human Face," is a notable exception. My testimony takes a similar perspective in looking at the crisis as seen and lived by its principle victims--workers, peasants, the unemployed and poor women and children throughout Latin America. Almost a year ago, an article in the Wall Street Journal observed,

> "Statistics quantifying their misery are often nonexistent or unreliable, but to authorities and experts working in Latin America, the empirical evidence leads to an inescapable conclusion: a whole region is being pushed backward, so that what was once middle class now plunges toward poverty, and what was once the poorer classes now lives hand to mouth. In terms of economic development, a whole decade has been lost....'

> "Across the region unemployment is rising, public health and nutrition are declining, children are abandoning school to feed themselves and their families, and among the working class and the poor, there is a deepening bitterness, growing out of a conviction that they are bearing an unfair share of the burden." ("Latin Crisis—As Debt Turmoil Ebbs and Flows in Mexico, Human Misery Persists," 6/12/86.)

There has been a definite reversal in all major indicators of well-being, and the groups most affected are least able to help themselves. It is calculated that in Latin America a 2-3 percent decline in national GNP usually results in a 10-15 percent decline in per capita indices for the poor. If we look at some of the sectors hardest hit by debt adjustments, the figures are staggering. Regionally, there has been an average 61 percent reduction in health and nutrition, and education is a close second at 59 percent. Unemployment, especially in the lower-paying, less secure job market, has increased dramatically and with it various forms of illicit activity from petty thievery to major drug traffic; official violence against the poor has increased commensurately. In all this, women and children suffer most.

Employment

Money isn't everything, but it is a matter of life and death when societies move away from subsistence agriculture and toward a society of specialized labor and of buying and selling products. Most of the people in Latin America today who live in rural areas do not own their land. Many do not even have the possibility of sharecropping but depend for their survival on what they can make as day laborers or seasonal employees. It is not surprising that peasants have fled the countryside for the cities in ever greater numbers. Thus most people in Latin America today live in urban areas and depend totally on jobs being available. They and their families stand only a paycheck away from destitution.

In the economic depression that has accompanied the debt crisis since 1982, unemployment has continued to rise. Throughout Latin America, it is common to find that 30 to 40 percent of working age people are either without work or work only sporadically or part-time. In Mexico, for example, more than 40 percent of the workforce is unemployed. Even those who hold jobs are often becoming poorer day by day. Between 1982 and 1985, real wages fell by 45 percent. It was precisely in that period that Mexico was being praised for heroic efforts to pay its international debts. The heroes of that failed effort were the people who lost their jobs, or who could never find one, or who worked harder and harder for less and less.

Peru is perhaps best known today for its current government's unilateral decision to pay only what it reasonably can (10 to 16 percent of total debt service) and temporary suspension of all profit remittances by foreign corporations, including service payments of private sector debt. At the time, Peruvian President Alan Garcia said, "We cannot pay the banks by sacrificing the people. We cannot seek fresh money just to pay old debts; nor can we renounce our economic sovereignty by accepting that others can make decisions as to how we conduct the economy." It is still too early to know what impact these measures will have on the national economy, much less the poor in Peru, but statistics are available from previous years.

Between 1975 and 1985 in Peru the average fully employed worker lost close to 60 percent of his or her buying power. During the same period, the number of fully employed people dropped from over 50 percent of the workforce to less than 35 percent. The human impact of such statistics is devastating. In my parish, after a sudden rise in prices, I met a woman in the market. She looked at me and then back to her empty hand, and said, "Bless me father, so that we won't have to eat."

Health, Nutrition, and Education

Due to the debt crisis, Latin America is failing to invest in the health and education of its human capital for the future. Most countries have slid backward amid growing inequity, environmental degradation, deindustrialization, and poverty. One of the greatest challenges of the current debt crisis is how to stimulate development based on principles of equity, justice and sustainability. The poor have suffered from economic policies over the last decade or so that have actually reduced their quality of life. Development today means creating a better tomorrow, but it must begin with the poor recovering what they have lost in recent years.

Not eating leads to hunger and malnutrition, which in turn can lead to death. In 1973, Peru was meeting the minimum calorie and protein needs of most of its people. By 1979, however, one study indicates that the typical Peruvian was consuming but 67 percent of the calories and 50 percent of the protein necessary to maintain health according to FAO standards.

In the summer of 1979, my fellow priests and I (we were four in a parish of 120,000) began keeping a count of emergency baptisms. We discovered we were baptizing two to three children a day in danger of death. Baptizing those children that summer is what caused me to ask why this was happening, and to discover that it was happening due to national debt payments.

At present, fifty percent of those who die in Peru are under five years of age; forty percent of the children are seriously malnourished. Peru's incidence of tuberculosis (TB) is the highest in the hemisphere. When I arrived in the parish in 1974, I rarely heard of a case of TB. Today, hardly a day goes by without a new case being reported. It is an epidemic. To be poor in Peru today is to expect to come down with TB.

Just before I left Peru, I visited with Felicita, a 22 year old polio victim who is the sole supporter of her four younger brothers and sisters, one of whom is mute. Felicita lost her two older brothers in

1982 to TB. They were 19 and 20 years old. Her parents, who were alive then, asked me to celebrate a mass for them. I buried her mother in 1985 and her father died in 1986 just before I returned from a sabbatical. They too were victims of TB. There is no doubt in my mind that the debt is the cause of their deaths, because money spent by the government to pay interest to foreign banks is money not invested in the health and well-being of the poor.

The poor, who did not borrow the money, have yet to benefit from it but are the ones who are burdened most severely with its payment — often paying with their lives. In a recent document of the Peruvian Bishops' Commission of Social Action, they estimate that the debt has cost about 20,000 victims a year -- mostly children.

This combination of joblessness and malnutrition has resulted in a culture of survival. In 1977, one third of the mothers in my parish worked outside the home; by 1982, it was two thirds. Most children have no childhood, rather they are workers with little time for play or study.

Some women living in urban shanty towns have developed positive responses, such as organizing "comedores populares" (neighborhood soup kitchens) where they can pool their meager cash resources to buy and prepare food in bulk and also provide child care-sharing services, freeing up time to seek other income. By and large, these are self-help efforts, sometimes assisted by outside resources from church and other private groups.

Education has suffered tremendously. Between 1977 and 1985, the Peruvian government's social budget was reduced by 18 percent. Hardest hit was education (especially primary) which accounted for 8 percent of that 18 percent reduction. Peruvian teachers were among the hardest hit, staging an 85-day strike in 1979 and a 118-day strike in 1980, all to no avail. One of their major demands was for food programs for the children. Teachers often complained to me that it was impossible for them to teach children so hungry that they could not keep their eyes open.

Over the past five years, I've seen the older brothers and sisters of these children graduate into frustration. As one priest friend of mine said, "...the only choices they have are to become a 'ratero, cocalero, o de Sendero'" (a thief, a cocaine trafficker, or a member of the Shining Path -- a terrorist group).

In Bolivia in recent years, IMF austerity measures have led to a doubling of food prices overnight and an inflation rate as high as 34,000 percent. Malnutrition in the Cochabamba Valley, one of the country's most agriculturally productive regions, increased from 11 percent to 56 percent of the population in three years. Primary school enrollment decreased by 6.3 percent in the same period. Conservative estimates put the number of children who are malnourished nationally at 50 percent and 60 percent of all families below the Bolivian poverty line.

In Northeast Brazil, some 45 percent of the land is controlled by one percent of the landowners. Under government "debt management initiatives" they have shifted production away from food crops for domestic consumption in order to grow sugarcane for gasohol (a petroleum import substitute) or crops for export. At the same time that export orange crop production increased 6 percent, corn and rice production for local consumption decreased 6 percent and 16 percent, respectively. Recent reports indicate that land reform violence has become endemic. Brazil's infant mortality rates have increased 8 percent in recent years, and 20 percent of all newborn children die before they are one year old. This is attributed to malnutrition.

In Mexico, the educational system filled some of its nutritional gap by providing healthful free school lunches to the students, most of whom seldom had breakfast. Last year, this lunch program was cancelled; now children often have trouble concentrating on their studies. Many are dropping out of school, unable to afford the smallest fees. Instead they go to the streets to beg, steal or try to sell anything to supplement their families' dwindling incomes.

Political Stability

Interfaith Action has long argued that money spent on weapons purchased for "defense" or manufactured for "export" trade balance, is money not spent on or for people, and that national or international security is not advanced when millions of people are not able to meet their basic needs. "The military competition for superiority in arms has no counterpart on the social side. National leaders compete fiercely for military preeminence (but)...there is no evidence of a race among nations for top rank in social goals (such as living standards)." (Ruth Sivard quoted in Maryknoll Sister - International Debt Crisis 6/86)

Debt repayment is already straining the limits of political systems in many Latin American countries, where desperate people strike, partake in food riots, enter into illicit activities, and struggle for access to land. In Peru, debt payments did not cause the emergence of the Shining Path, a violent terrorist group, but it did add fuel to its fire, as did the perennial neglect of Peruvian governments since Independence. Peru's income distribution has long been among the most inequitable in the world. Previous debt policies exacerbated the problem and gave a helping hand to the terrorists.

In Bolivia, miners, peasants and others have responded to the debt crisis in various ways. National, regional and sectoral strikes have been common since the current government began imposing IMF austerity measures. Illegal activity, especially drug-related, pervades all social and economic classes. The government responds to both (strikes and drug-related activity) with violence and oppression. A Harvard University economist who advised the Bolivian government in the design and implementation of the IMF-imposed austerity measures now admits that they aren't working--and argues that Bolivia should simply stop paying its debt. For the thousands who have suffered the violence of military repression and the daily hunger for food they cannot afford, this advice is late at best.

In Mexico, as in Bolivia, such suffering, on the one hand, and corruption, on the other, does not escape the notice of the Mexican people. Mexico may be the Latin American country with the greatest relative capital flight; while poor and lower middle class families struggle to survive under IMF-imposed austerity conditions, wealthy Mexicans are exporting their money as fast as they can, legally and illegally, often depositing these funds in the very banks which are demanding repayment at all cost. It is estimated that between 1976 and 1985 over $US 53 billion left Mexico in this way. This represents more than half of Mexico's total debt. Popular groups of urban workers and rural peasants are now demanding self-reliant development strategies with land reform to enhance domestic food production, better wages, manufacturing for internal markets and the satisfaction of basic needs through cooperatives and small scale industries.

Ecology

Finally, the ecological security of the continent and, therefore, the entire globe is at risk. Much of the export increases come from raw materials, especially from the land. Agribusiness extraction cuts down rainforests, uses dangerous pesticides, and pays little heed to soil and erosion control. In those countries where environmental conservation programs may have existed, these programs have suffered budget cuts just when they are most needed. Small farmers growing food for domestic consumption using traditional conservation technology may be driven off their land by competition or financial desperation. Peasants migrating to cities add to urban environmental congestion in areas where sanitation, clean water, and other infrastructures are already overloaded and in a state of disrepair. Just as failure to invest in human capital has set the region back, so, too, failure to protect the environment has serious repercussions for future generations.

Conclusion

In conclusion, let me briefly mention that a consensus seems to be developing in the interfaith community about some principles which should form a moral test for all proposals dealing with the issue of international debt.

1. The poor should not bear the burden of adjustment. Living standards of those least responsible for the debt and most vulnerable should not be sacrificed in order to meet external financial obligations.

2. The burden should be shared equitably between creditor institutions and the debtor governments, corporations and elites that incurred the debt.

3. Factors adding to and perpetuating the debt problem but beyond the control of debtor countries--such as budget deficits, interest rates, commodity prices, and trade barriers--should be alleviated.

4. Developing nations should not be forced to surrender their right to political self-determination or economic self-reliance in exchange for relief.

5. Debt relief should be fashioned in a way that benefits the poor and helps move debtors beyond debt repayment to development.

6. Long term solutions should promote a more just international economic system in order to prevent such crises from recurring.

We recommend these principles to you in establishing a more just and effective US policy on the debt issue.

Once again, I want to thank you for the careful attention that you are giving to the debt crisis and for giving me this opportunity to share my perspective with you this morning.

STATEMENT OF SALLY SHELTON-COLBY, CONSULTANT, WASHINGTON, DC

Ms. Shelton-Colby. Thank you, Mr. Chairman. I will synthesize my remarks, as you requested. I have focused my testimony on the political and economic impact of the debt in Latin America but I think much of my analysis holds true for non-Latin debtors as well.

I think the record should reflect that a very, very great deal is at stake here. I think it does not need to be repeated to this committee that the United States has enormous strategic, political, and economic interests in Latin America and the Caribbean Basin, an area vital to our national security.

I am heartened, Senator Bradley, by your interest in focusing on the political and social effects of the debt because most of the debate so far on the Third World debt issue has taken place within an economic and financial context. I want to compliment the two witnesses who went before me on their very moving description of the social impact of the debt.

To me, it is remarkable that Latin America has remained as relatively quiet and as stable politically as it has over the last five years, which have obviously coincided with the worst economic deterioration since the Great Depression.

I would like to offer four possible explanations as to why Latin America has remained relatively quiescent in the face of staggering economic deterioration and why Latin America is facing the limits of its ability to endure economic stagnation. I would suggest that over the last five years, the middle class has been living off the savings which had accrued during the boom years of the 1960s and the 1970s; now those savings are virtually depleted.

Second, the extended family network has proved to be somewhat more resilient than we might have anticipated; but there are limits as to how far even the extended family network can cushion the impact, year after year, of growing unemployment. Third, there has been a broadly acknowledged need for economic adjustment in Latin America in an effort to get growth going again. And the populace of Latin America, I believe, has been willing to share in the burden of the economic adjustment process for a while, in anticipation of its eventually producing a return to international creditworthiness and a tangible improvement in the conditions of people's lives.

That has obviously not happened. Many economic indicators are worse today in Latin America than they were when the debt crisis first broke upon us in 1982.

Fourth, the democratization process that has occurred in Latin America over the last five years has served not only to divert Latin America's attention away, to some extent, from the debt burden but also has raised expectations that a democratically elected government would be more adept at economic management and more responsive to the economic and social needs of the people than an authoritarian government.

Mr. Chairman, the first two witnesses have talked very graphically about the social cost, and Father Burns particularly in a hands-on way, that I could not. Permit me to just share with you some of the very tentative data that we have begun to collect which reflect the social toll that debt has taken in Latin America.

During the 1970s, most scholars of Latin America estimate that 40 percent of the population of the area was living in poverty. Not only has there been no significant improvement but virtually every social indicator—malnutrition, disease, caloric intake, infant mortality—is worse today than in 1975.

I believe it was Father Burns who mentioned that Latin America has experienced a lost decade of growth; in some countries—the Andean countries, Central America, and the Caribbean—I would suggest that there may be close to two decades of lost growth and development.

I think one can come to no conclusion other than that the Latin America of the 1990's and the 21st century will be a less healthy, less educated, and less nourished Latin America even than that of today.

To turn to the economics, there is no question but that Latin America has generally been very serious about the economic adjustment process. Some important and politically painful efforts to adjust their economies have been made. Budget deficits have been reduced; at a time when the U.S. doubled our national deficit, Mexico, for example, cuts it in half. Inefficient State-owned enterprises have been privatized or closed. Tariffs and quotas protecting local industry are in the process of being dismantled. Current account deficits have been reduced in many countries. Currencies have been devalued in order to maintain internationally competitive exchange rates. Exports have been substantially expanded, and imports have been cut. In fact, in some countries—again, Mexico is a case in point—some degree of flight capital has even begun to return.

However, Mr. Chairman, Latin America's economy is still in trouble. 1986 per capita income remained below the 1980 level. Commodity prices, according to World Bank data, fell to their lowest level in 50 years. Gross domestic product slipped by almost a full percentage point in 1986 from the already low level of 1985. Population growth has spurted ahead of economic growth.

The oil exporting countries saw their 1984 $8.6 billion current account surplus replaced by a $7.5 billion deficit in 1986. And their trade surpluses financed only one-quarter of their interest payments, instead of all of them as previously. Of all Latin America, only Chile and Colombia seem to have been able to pursue the economic adjustment process and to have achieved a reasonably healthy rate of sustained economic recovery.

In most countries of the region, debt indicators grew worse. I would like to ask the subcommittee's permission to insert into the record some Treasury Department data which were compiled just last week. They are partly drawn on IMF data and partly from Treasury's own sources. The data reflect that, in terms of size of external debt and a series of ratios—debt to export ratios, debt to GDP ratios, and debt to service ratios—all the numbers are worse than in 1982, when this debt crisis first burst upon us.

Senator **Bradley**. Without objection, that will be submitted to the record.

Ms. **Shelton-Colby**. Just to give you one figure—and I won't take the subcommittee's time with many—debt to export ratios rose 17 percent to a new historic high, and debt to export ratios were 60 percent higher than before the onset of the debt crisis. Put another way, according to the Economic Commission for Latin America, interest payments last year accounted for 5.3 percent of GDP while the trade surplus last year accounted for 2.3 percent of GDP. In other words, the debtor countries are paying twice to the banks in terms of interest payments what they were achieving in terms of trade surplus.

To the Latin American-in-the-street these macroeconomic figures mean high unemployment, a high rate of bankruptcies, high prices, and higher costs of education and health care for a populace whose per capita income has plunged. At the same time, Latin America has been remitting on the average approximately—sometimes more, sometimes less—$25 billion per annum in net capital flows to banks and profits to corporations while new lending and investments have virtually dried up.

Latin Americans have begun to question the efficacy of a strategy that has achieved neither a return to financial creditworthiness nor resumption of economic growth. There are obviously limits, Mr. Chairman, to any country's ability to endure, year after year, social and economic decline; Latin America is no exception, particularly as it comes after more than a quarter century of sometimes spectacular economic growth.

One of the remarkable things that I note during my monthly visits to Latin America is that it is no longer just the extreme left which is calling for debt relief, but rather the broad sentrus elements and the right, including members of the private sector. So, I would conclude, Mr. Chairman.

I would not go over my own proposal which involves substantially more relaxed concessions for managing the debt, but let me conclude by emphasizing that in order to get growth going again, debt relief is absolutely essential. I have my own definition of debt relief, which will be contained in my testimony. I believe that we do have to be concerned about how we get new capital flowing into Latin America.

The World Bank estimates roughly that for Latin America to achieve a 45 percent level of growth, approximately $20 billion of new money per year is going to be essential. So, I do think we have to be concerned about how we keep the banks in the ball game. And any strategy—and there are many under discussion—for reducing the debt service burden has to keep in mind the importance of being able to get new money coming in.

But my own personal view—and it is not shared by most bankers—is that a reduction in the debt service burden will result in a resumption of economic growth and even the banks will be back into those capital markets for new lending so fast our heads will spin. Thank you, Mr. Chairman.

Senator **Bradley**. Thank you very much for your testimony, Ms. Colby. Now, we will hear from Mr. Richard Feinberg, Vice President of the Overseas Development Council, Washington, D.C. Mr. Feinberg?

[The prepared written statement of Ms. Shelton-Colby follows:]

TESTIMONY BY SALLY SHELTON-COLBY
Consultant

SUBCOMMITTEE ON INTERNATIONAL DEBT
COMMITTEE ON FINANCE
U. S. SENATE

March 9, 1987

Mr. Chairman, I applaud the Subcommittee for holding these hearings on proposals to provide relief to those affected by the international debt problem. For some time the debate on how well Latin debtors especially were managing the external debt crisis has veered between extremes. Some have pronounced the debt crisis behind us and some debtors as being on the verge of returning to creditworthiness. Others have predicted widespread failure to recover economically and growing political demands for new approaches. A large number of new proposals have surfaced for dealing with the debt, many involving debt forgiveness.

I would like to share with you and the Subcommittee, Mr. Chairman, my evaluation of the economic situation in Latin America and then discuss a new, much more complex element, the politics. The record should reflect that a very great deal is at stake here. The U.S. has vitally important political and strategic interests in Latin America and the Caribbean which could be jeopardized by prolonged economic stagnation in the region. A democratic, economically healthy Latin America is vital to U.S. interests and to cooperative efforts in the areas of drug eradication, migration, trade, and security. It is also an essential ingredient in our ability to project our military capability on a global basis. Lacking the need to maintain substantial force levels to secure our southern border, we are free to deploy those forces in areas of immediate potential conflict, such as the Middle East and the Korean Peninsula. In addition, our ability to meet our NATO commitments in the event of an outbreak of hostilities in that area would be directly dependent on unimpeded access to sea lanes of communication passing through the Caribbean Basin and the northern part of South America. And the Panama Canal remains important, though less so than in the past, to U.S. commercial and strategic interests.

Economically, the almost 400 million people of Latin America are an obvious important market for U.S. exports. Latin America takes one-fifth of our exports, or used to before the debt crisis took its toll on our sales to that market. With one out of every six American jobs directly related to exports, it is clear that economic deterioration in Latin America not only affects our exports, which fell by $15 billion between 1981 and 1983 alone, but also affects employment in this country. Over 400,000 jobs--- and some have put it at twice that -- have been lost in the U.S. as a result of the downturn in Latin America's economy; the impact in some areas, such as my home state of Texas, has been devastating.

The effect of economic decline and induced austerity on the social and political system of Latin America is growing serious. It is remarkable that Latin America has remained as stable as it has during the worst economic crisis it has faced since the Great Depression. I would like to suggest four explanations for Latin America's relatively muted response -- to date-- to the debt crisis. First, the middle class has been living off savings accrued during the boom years of the sixties and seventies. Second, the extended family network has so far been surprisingly resilient. Third, the need for economic adjustment in order to resume growth has been acknowledged by an educated, aware populace willing to share in the burden of adjustment for a time. Fourth, the democratization process has raised hopes that democratically-elected governments would be more adept at economic management than authoritarian regimes.

Mr. Chairman, these four elements cannot and will not continue to cushion the impact of debt indefinitely. Middle income sector savings are close to depletion. Lower income sectors are now bearing the burden of social ills which many thought were gone forever. Economic retrenchment has not yet brought about sufficiently robust economic growth as a reward for years of austerity. Democratic regimes have to be more responsive than authoritarian governments to increasingly frustrated Latin American voters whose incomes have fallen to roughly the level of a decade ago.

Permit me to comment briefly on one aspect of the debt crisis which has received far too little attention: the social cost. There is a tendency among those of us who work on Latin America to focus on the stunning modernization process that has obviously occurred in Latin America over the last 25 years. It is true that Latin America is now more urban than rural; that manufactured products, including arms, compete with if not outpace exports of coffee and other basic commodities; that Latin America's GNP has grown to 20% of the U.S.'; that production in Latin America during most of the past 25 years has grown at a faster rate than in the U.S.; and that major investments in social infrastructure put Latin America on a par with middle-income Western European countries.

But these data mask a social situation in Latin America seriously exacerbated by the debt crisis. It is estimated that 40% of the population of that area was living in poverty during the 1970s and there is no evidence of any significant change for the better. On the contrary. Reliable data on social decline are not yet available, but some general observations can be made. There is little question that malnutrition has increased substantially. Diseases which were thought to have disappeared decades ago have reappeared. The average Latin today consumes fewer calories daily than in 1975 when it was estimated that only one-third of the population ate a subsistence diet. Infant mortality rates have risen sharply. Population pressures resulted in over ten million people entering the work force between 1981-1983 alone. In addition, it appears that the distribution of income, traditionally unevenly distributed in Latin America, has worsened considerably...all this in an area with virtually no social security safety net and double-digit unemployment. I would also call the Subcommittee's attention to the long-term impact of the cuts in social programs which Latin America is being forced to make. Can one come to any conclusion other than that the long-term social imapct of debt will be a severely less healthy, less educated, less nourished Latin America than that of today?

Most Latin governments have made serious, and politicaly painful, efforts to adjsut their economies. Budget deficits have been reduced (Mexico has cut its in half), inefficient state-owned enterprises have been privatized or closed, tariffs and quotas protecting local industries have begun to be dismantled, currencies have been devalued to maintain competitive exchange rates, exports have been substantially expanded and imports cut. In fact some flight capital has even returned.

Houver, Mr. Chairman, Latin America's economy is still in trouble. 1986 per capita income remained below the 1980 level. Non-oil commodity pricess fell to their lowest level in fifty years. Gross domestic product slipped by almost a full percentage point from the already low 1985 level. Population growth spurted ahead of economic growth. The oil-exporting countries saw their 1984 $8.6 billion current account surplus replaced by a $7.5 billion deficit in 1986 and their trade surpluses financed only one-fourth of their interest payments instead of all of them as previously (source: Economic Commission on Latin America). Argentina and Brazil, in spite of a decline in the price of oil and interest rates, ended 1986 with current account deficits. Inflation re-surfaced as a serious problem in some countries. Only Chile and Colombia were able to continue the adjustment process and achieve reasonably healthy level of growth. In most countries of the region debt indicators grew worse as the U.S. Department of the Treasury has acknowledged. According to World Bank data, debt to export ratios rose 17% to a new historic high for the region generally. In fact, debt to export ratios were 60% higher than before the onset of the debt crisis. Interest payments to export ratios were 20% higher, in spite of the fact that LIBOR fell by well over 50% in these years. Put another way, interest payments amounted to 5.3% of GDP in 1986 while the trade surplus amounted to 2.3% of GDP; obviously the latin countries paid teh banks more than they earned, leaving nothing for growth. Where growth has occurred it has been short-lived and fragile, with few exceptions.

To the Latin-in-the-street, these economic indicators mean recession: high unemployment, high rate of bankruptcies, high prices, and higher-cost education and health care for a populace whose per capita income has plunged. At the same time, Latin America sent abroad about $25 billion per annum in net capital remittances during the past five years while new lending and investment have virtually dried up. Even Brazil, for the first time in several years, experienced no meaningful new investment.

The toll on the U.S. economy through lost exports has been serious as well. A September 1986 report prepared by the Democratic Staff of the Joint Economic Committee indicates that developing countries accounted for 87% of the $23 billion recorded decline in U.S. exports through 1985. Exports to Latin America fell by $12 billion, or about 55% of the total decline. While the strong U.S. dollar might explain this situation in part, this same report points out that U.S. exports to industrial countries fell by less than 2%, or roughly $3 billion. The fall-off in U.S. exports to the highly indebted Latin countries can be explained by the fact that Latin governments restrained demand through the reduction of governmental expenditures and real wages. In addition, currencies were devalued so that exchange rates promoted exports and discouraged imports. In spite of a sharp increase in the volume of goods exported, severely deteriorated terms of trade meant that the unit value of exports fell 20% for non-oil exporters and 45% for oil exporters, thereby virtually eliminating the effects of the increased exports.

Mr. Chairman, Latin Americans have begun to question the efficacy of a strategy that has achieved neither a return to financial creditworthiness nor a resumption of economic growth. There are limits to any country's ability to endure social and economic decline and Latin America is no exception, especially after almost a quarter century of (sometimes spectacular) economic growth. Those limits are evidenced by the appearance of a broad new set of demands from the Latin populace for debt relief and economic growth. These demands are emanating no longer just from the extreme left but also now from mainstream centrist democratic political elements and even from the local private sector. Throughout Latin America, governments have begun to reject the idea of continued austerity merely in order to service the debt and instead are moving increasingly towards the growth option, even if that has to occur at the expense of the foreign banks. While the political mainstream in Latin America welcomed the Baker Plan's emphasis on growth, it is dubious about the potential success of a strategy that would increase the absolute size of the debt without concomitant concessions to ease the debt service burden. In Brazil, for example, President Sarney's policy of prioritizig growth over debt servicing is broadly supported by the majority of Brazil's political leaders. If a choice between growth and servicing the external debt were to become necessary, no major political element in Brazil today would favor servicing the external debt at the expense of domestic economic growth. Underpinning this development is the recognition that Brazil's newly democratic government will have to face that country's enormous social problems whose solution will require the expenditure of substantial public funds. A recent report prepared at the request of the Government of Brazil concludes that though Brazil's economic progress has been dramatic, its social indicators put it among the hemisphere's least developed countries. While Brazil has long suffered staggering social underdevelopment, it will not be so easy to ignore under a democratic administration. Therefore, the new Brazilian government will have to make some hard choices between servicing its external debt and achieving growth levels high enough to allow it to address in a serious way the social demands building up under twenty-five years of military government.

The Mexican Government as well has opted for a pro-growth strategy which required the international financial community to come up with a new approach to that country's debt, one that involves less austerity and more growth. Pressures from within the Mexican political establishment itself -- not to mention from opposition parties, the private sector, agriculture and trade unions -- are escalating. Many components of the ruling PRI power structure have called for debt relief as an essential ingredient in reversing the economic decline Mexico has experienced for most of the past five years. These pressures produced 1986's unprecedented Mexico-IMF agreement, negotiated with the backing of the U.S. Government, and the subsequent agreement with the commercial banks. Both legitimate more growth and less austerity in the form of substantially increased capital flows and higher than ever before budget deficits. It was based in part on a presumption by U.S. Government and IMF officials that social and political pressures in Mexico were explosive and an early resumption of growth was therefore indispensable.

In Argentina, the Alfonsin dministration as well is coming under intense pressure from all major elements of the Argentine body politic, including his own Radical Party, to get growth going again. This pattern is replicated across the continent as Latins begin to express their unwillingness to tolerate additional recession or stagnation as the price of servicing the external debt. Peru's refusal to service the external debt and its achieving 8.5% growth this year cannot but have made an impression on the rest of the continent.

Unless growth resumes soon, the international financial community may see not only a prolongation of Brazil's suspension of interest payments but over the longer-term other countries following suit. This could seriously jeopardize the banks and create new strains in the U.S. banking system. The general vulnerability of the banking system to external shocks is significantly less than at the onset of the debt crisis in 1982. U.S. money center bank exposure to the nine most highly indebted countries has fallen from 170% of primary capital in 1982 to 110% by the end of 1985. This is due primarily to an increase in primary capital of 56% between 1982 and 1985. This has produced a fall in exposure relative to capital to the most highly indebted countries from 170% in 1982 to 110% in 1985. In addition, reserve levels have now been built up and reserve accumulation will presumably continue to grow.

If the banks were to face an indefinite suspension of debt service by a major debtor or debtors and were to retaliate by suspending short-term credits or seizing foreign assets, serious new frictions would arise in the already tense relationship between the U.S. Government and its important Latin allies. This could carry over and damage important U.S. interests in other areas such as cooperation on drug enforcement, migration, trade, and of course Central America. Moreover, it could provide fertile ground to the blandishments of Soviet General Secretary Mikhail Gorbachev during his first visit to Latin America later this year.

To return to the Baker Plan, creditor and debtor countries and financial institutions generally reacted favorably to the idea, especially to the notion of stressing the need for resumption of growth; however, there was considerably less enthusiasm, at least among the banks, for actually increasing lending. While the banks have signed on rhetorically, they have yet to commit significant new funds to the area and net lending has actually declined dramatically. In 1985 net capital inflows into Latin America were only $2 billion and in 1986 $9 billion.

Commercial bank attitudes towards new lending to Latin America, Baker Plan or no Baker Plan, can largely be explained by the shock that the banks experienced in 1982 and subsequently from the failure of Latin America to have rcovered creditworthiness within the time frame anticipated. They continue to be reluctant to take on usbstantial new risk, especially without some kind of guarantee from either official or multilateral bodies.

Mr. Chairman, may I venture my own, personal views on where and how we go from here. There is no question that a new approach to managing the debt, acceptable to both creditors and debtors, is necessary. Latin America and other debtors can no longer afford, econmically or politically, to spend such a large percentage of export earnings and government revenue to service the external debt. Some form of debt relief, that is, a reduction in the debt service burden, is required in order to get growth going again and to achieve a return to creditworthiness on the part of the debtors. At the same time debt relief has to be implemented in such a way as to safeguard the stability of the international financial system. At this point I am inclined to think that, before moving towards dramatic new solutions such as major debt write-downs or the creation of new facilities to purchase discounted bank paper, we should try a simpler approach. I believe that LDC debt should be stretched out over a much longer time frame, perhaps forty years or more, to reduce servicing requirements significantly. Interest rates charged by the banks should be brought way down; if interest rates go back up, then the World Bank and/or the IMF should create a new facility to cushion the impact on LDCs. Banks should agree to a slower pace of adjustment in order to preserve their hopes of repayment which would be jeopardized by the disruptive social and political side effects of the present trends. Like it or not, commercial banks must set up "country growth funds" to ensure the debtors a reasonable level of growth; terms could depend on the condition of each borrower. Bank overseers must adjust their regulatory requirements so as to give the banks more time and flexibility to adjust to reduced income and increased exposure. Debt forgiveness should only be needed for the poorest countries.

The debtors must renew their commitment to economic adjustment which, along with international monitoring of that process by the IMF, should be a condition of the more relaxed repayment terms. Those countries which find the IMF politically unacceptable could agree to a new monitoring process: periodic reviews of domestic economic performance by the more sympathetically-viewed World Bank (which could include IMF personnel on its teams). This would be the basis for determining future disbursements into the debtors'growth funds by the banks. Debtors should also vigorously promote debt-to-equity conversions as an effective albeit modest way of reducing the stock of debt. Sustained commitment to economic adjustment and the resumption of growth are also the best means for inducing not only the return of flight capital but also new foreign capital.

The U.S. Government and others, besides relaxing the banks' regulatory environment, should not insist that official credits be repaid before comemrcial credits, should link bridge financing for LDCs to compliance with adjustment programs, and should consider such new tools as government and World Bank guarantees of commercial bank financing in order to stimulate new capital lending.

Mr. Chairman, a reduction in the debt service burden and continued efforts at adjustment should result in economic growth, the only sure way of defusing this increasingly explosive conundrum, and of as much value to the American economy as the Latin.

STATEMENT OF RICHARD E. FEINBERG, VICE PRESIDENT, OVERSEAS DEVELOPMENT COUNCIL, WASHINGTON, DC

Mr. **FEINBERG.** Mr. Chairman and Senators, we are all accustomed to thinking of the rich industrial nations as being a source of funds for the poor developing nations; but today, in a perversion of economics and ethics, the Third World is now massively assisting the industrial nations, and this dramatic turn-about was sudden and unanticipated.

Latin America benefitted from positive resource transfers of $62 billion between 1978 and 1982. Over the last five years, Latin America has been obliged to transfer $132 billion to foreign creditors; that is to say, interest payments plus amortization exceeded new lending to the international financial system by $132 billion. It is this capital drain that is behind the social realities so eloquently described here today by previous witnesses.

This mammoth resource transfer not only inhibits growth in debtor countries but, as you, Mr. Chairman, have pointed out, also shrinks U.S. export markets. Moreover, in order to generate the foreign exchange needed to meet interest payments, debt-ridden nations are compelled to run large trade surpluses. So, the debt crisis simultaneously diminishes U.S. export opportunities while obliging us to purchase more Third World production.

In considerable measure, the annual $50 billion-plus trade deficit that the United States is running with the Third World is the inevitable counterpart of this reverse resource drain.

My colleague from the Overseas Development Council, Stewart Tucker, testified before Congress last year that the United States had lost about 600,000 jobs due to the decline in exports to the Third World between 1980 and 1985, about 360,000 of which jobs were lost in Latin American markets.

Additionally, about 930,000 jobs would have been created in the United States if the growth trend of the 1970s had been continued after 1980 in Latin America and the Third World. So, in sum, nearly 1.6 million U.S. jobs have been lost due to recession in the Third World. Certainly, some developing nations maintain high and unfair levels of protectionism. Nevertheless, today the crucial barrier facing U.S. exports in many markets is not tariff codes but dollar shortages.

Every dollar shipped to money center banks is one dollar less to spend on wheat grown in Iowa or trucks made in Michigan. I would argue, Senator, that the current allocation of the debt burden does not respond to our long-term national interests. It places the interest of the banks above the interests of our export-oriented manufacturers and farmers and has sapped the strength of debtor country economies to the detriment of U.S. security and U.S. economic growth.

A revised debt strategy that reduces the reverse resource drain could yield a more equitable balance of the costs of adjustment. To be sure, the resource transfer can be reduced and must be reduced in ways that do not compromise the stability of the financial system; but that can be done in ways that bring tangible benefits to U.S. farmers and manufacturers, improve the U.S. trade balance, and assist developing nations.

The reverse resource drain could be reduced through more lending, as the Baker initiative favors. However, as is now obvious—18 months into the Baker plan—many commercial banks shy away from this solution.

There is another option available for reversing the resource drain, and that is that banks could cut their intake of debt service. If the commercial banks prefer this option, numerous methods exist for reducing debt service payments. For example, if all interest due to international banks were fully capitalized—not written off, but capitalized—and amortization payments were automatically refinanced, then the net transfer of resources from Latin America to the banks would go to zero. That is roughly the additional $20 billion in resources called for by the World Bank and others to get Latin America back on track. That would end the resource drain.

From such a solution, the U.S. economy would benefit directly from such an increase in the region's purchasing power. For example, in the third year of such a plan, U.S. exports to Latin America could increase by about $11 billion, and within 10 years of that plan, could rise by $17 billion.

The corresponding increase in U.S. jobs would be approximately 230,000 in three years and 355,000 in 10 years.

Alternatively, suppose the banks eliminated the interest rate spread—now about one and a half percent—and also wrote down their Latin American debt by 30 percent to what secondary markets suggest is roughly their true value, at three percent a year over 10 years? That, Senator, is a variant on one of your proposals. This proposal, which I would call a market value approach to debt relief, could boost U.S. exports by $3.3 billion after three years and $8.5 billion within 10 years. The corresponding increase in U.S. jobs would be about 68,000 in three years and 177,000 in 10 years.

And summing together the advantages over a 10-year period, this market value formula could boost U.S. exports by a cumulative $52 billion and U.S. person-years of employment by over one million jobs.

Now, no improvement in the debt/trade equation that destabilizes the U.S. banking system would be in the national interest; but there is some room for maneuver. The commercial banks are in a better position today than when the debt crisis hit in 1982 and could absorb a higher proportion of the costs of their past mistakes. A revised debt strategy that reduces the reverse resource drain is more likely to stimulate adjustment with growth. It would spread the cost of adjustment more equitably among sectors within the United States and between creditors and debtors. It could improve the U.S. trade position, enhance our leadership role in international economic affairs, and improve our diplomatic relations with developing nations.

I note today's hearings want to concentrate on description rather than prescription, but let me just very briefly sketch the principles behind what I see as a more equitable adjustment strategy.

Senator **Bradley**. Mr. Feinberg, could you submit that for the record because we are in need of some time?

Mr. **Feinberg**. I would be glad to, Senator. It is in my written submitted testimony.

Senator **Bradley**. Thank you very much.

[The prepared written statement of Mr. Feinberg follows:]

THIRD WORLD DEBT: TOWARD A MORE BALANCED ADJUSTMENT

Statement by

Richard E. Feinberg
Vice President, Overseas Development Council

before the
Subcommittee on International Debt
of the
Committee on Finance
United States Senate
Washington, D.C.
March 9, 1987

Mr. Chairman, I am pleased to have the opportunity to testify today on a subject of great importance to the U.S. economy, our foreign policy, the international financial system, and the future of many developing countries. The cancerous debt burden has not terminated the afflicted parties, but it is damaging many of our interests. The debt disease eats at the foundations of our banking system, shrinks our export markets, and irritates our foreign relations. For the developing nations, this persistent illness deepens poverty, consumes scarce national savings, undermines adjustment efforts, and threatens eventually to destabilize emerging democracies.

We are at the mid-way point in the Baker Initiative, since the three-year plan was first announced in October, 1985. This is a propitious time to evaluate its accomplishments, which are significant, as well as to identify its shortcomings. We should build on its strengths, and suggest new measures to correct its weaknesses.

The Baker Initiative: a Balance Sheet

Secretary of the Treasury James Baker astutely noted that the major debtors were tiring under the weight of prolonged austerity. He therefore advocated combining "adjustment with growth." In effect, he was saying that the debtors could and should simultaneously service their debts and expand their economies. To attain this felicitous outcome, three conditions must be met:

1) The net outflow of capital that has been draining developing countries of scarce savings must be stemmed;

2) The global economy must provide an external stimulus to growth; and,

3) The developing countries must make better use of available resources.

Unfortunately, only the third condition is being met. The record among the many developing countries is of course mixed, but I would concur with a recent World Bank assessment: "The commitment to adjustment policies in 1986 was encouraging, both in geographic coverage and for its scope within the debtor economies." 1 Many countries tightened budget deficits, devalued their currencies, reorganized their public sectors, and increased incentives to savings and investment. Since October, 1985 eight of the fifteen major debtors have signed standby agreements with the International Monetary Fund, and ten have accepted World Bank conditional loans requiring significant structural reforms.

The developing countries' efforts have not been rewarded by a supportive external environment. Global growth is subdued, as slackened U.S. growth has not been offset by expansion in the economies of Japan or Western Europe. World trade grew by a modest 4 percent last year, and non-oil commodity prices fell by 10 percent relative to the prices of manufactured exports, to their lowest level in at least fifty years.2

Especially disappointing has been the performance of international lenders. Rather than expand their lending in response to debtors' adjustment efforts, U.S. commercial banks have cut their credit lines. U.S. banks sliced their outstanding credits to non-OPEC developing countries by $8 billion in the first three quarters of 1986, and by $5 billion to 15 major debtors.

The banks consider many of the debtors still to be uncreditworthy. They note that some key indicators of creditworthiness have not improved and have even deteriorated for many countries. For Latin American nations, the ratio of interest payments to export revenues remains stuck at an unhealthy 35 percent, while the total debt/GDP ratio hovers near 50 percent.3 Furthermore, bank managers see more promising business opportunities in domestic and other OECD markets, and in new, non-traditional forms of intermediation.

The banks may also feel under less pressure to lend. Having strengthened their capital base and built reserves, they feel less vulnerable to the threats of most debtors. The cautious behavior of most debtors has also created complacency among many bankers. Moreover, despite intermittent efforts, the U.S. government and the multilateral lending agencies have failed to apply persistent, forceful, and concerted pressure on the banks to resume lending.

Among official lenders, the World Bank stands out in 1986 for having struggled successfully to increase its lending to the major debtors. This laudable trend began under the presidency of Tom Clausen and has accelerated under the leadership of Barber Conable. But these efforts are being offset by the other Bretton Woods agency, the International Monetary Fund. IMF net lending to the fifteen major debtors declined from $3.8 billion in 1984 to $1.7 billion in 1985, and dropped to a slightly negative sum last year.

Fund credit declined for reasons of both supply and demand. Industrial-country members of the Fund have limited borrowers' access to Fund resources. They have also argued that the Fund is a short-term lender, whose purpose would be compromised by extended exposures. The Fund has steadfastly refused to postpone the mounting repayments due on credits made in the earlier years of the debt crisis. For their part, some developing countries are becoming increasingly resistant to the conditions attached to Fund credit, and to the intrusiveness of Fund policy reviews.

Ironically, although the debtors were never signatories to the Baker Initiative, many have fulfilled their assigned role, while the United States and other creditor nations have failed to provide the stimulative external environment, and the necessary capital flows, that would enable the Third World's adjustment efforts to bear fruit.

The Resource Drain

We are accustomed to thinking of the rich industrial countries as a source of funds for the poor developing nations. But as a result of the build-up of massive debts, high interest rates, and the drying up of new credit, the direction of the resource flow has reversed. In a perversion of economics and ethics, the Third World is now assisting the industrial nations.

This dramatic turnabout was sudden and unanticipated. Latin America benefited from positive resource transfers of $62 billion during 1978-81. Over the last five years, Latin America has been obliged to transfer $132 billion to foreign creditors.4 In 1986, the total of developing nations' interest payments and amortization of long-term debt surpassed new lending by about $30 billion.5 Private creditors were the main beneficiaries of this tremendous capital outflow. In addition, the IMF drained another $5 billion in resources from countries still struggling to stabilize their economies.6

The Debt-Trade Equation

This mammoth reverse resource transfer not only inhibits growth in debtor countries, but also shrinks U.S. export markets. Moreover, to generate foreign exchange to make interest payments, debt-ridden nations must run large trade surpluses. So the debt crisis simultaneously diminishes U.S. export opportunities while obliging us to purchase more Third World production. In considerable measure, the annual $50 billion-plus trade deficit that the United States has been running with the Third World is the inevitable counterpart of the reverse resource drain.

My colleague from the Overseas Development Council, Stuart Tucker, testifed before Congress last year that the United States had lost 632,000 jobs due to the decline in exports to the Third World between 1980 and 1985. Additionally, roughly 930,000 jobs would have been created if the growth trend of the 1970s had continued after 1980. In sum, nearly 1.6 million U.S. jobs have been lost due to recession in the Third World.7

Certainly some developing nations maintain high and unfair levels of protection. Nevertheless, today the crucial barrier facing U.S. exports in many markets is not tariff codes but dollar shortages. Every dollar shipped to money-center banks is one dollar less to spend on wheat grown in Iowa or trucks made in Michigan.

The current allocation of the debt burden does not serve our long-term national interest. It places the interests of the banks above the interests of our export-oriented manufacturers and farmers, and has sapped the strength of debtor-country economies, to the detriment of U.S. security and economic growth. A revised debt strategy that reduces the reverse resource drain could yield a more equitable balance of the costs of adjustment. The resource transfer can be reduced in ways that do not compromise the stability of the financial system but that bring tangible benefits to U.S. farmers and manufacturers, the U.S. trade balance, and to the developing nations.

Reducing the resource drain would give a double-barreled boost to U.S. exports. In the first round, U.S. exporters would benefit from the increased purchasing power of debtor nations.

In a second round, U.S. exporters would benefit further as developing nations grew and their markets expanded.

The reverse resource drain could be reduced through more lending, as the Baker Initiative favors. Many commercial banks, however, shy away from this solution. They have been setting aside reserves against outstanding loans to the region, and are themselves concerned about piling up new debts on top of possibly devalued ones. Another option is available: Banks could cut their intake of debt service.

For commercial banks which would prefer this option, numerous methods exist for lowering debt service payments. For example, if all interest due to international banks *were* fully capitalized and amortization payments automatically refinanced, the net transfer of resources from Latin America to the banks would go to zero. The U.S. economy would benefit directly from such an increase in the region's purchasing power. In the third year of such a plan, U.S. exports to Latin America could increase by an estimated $20 billion, and within 10 years could rise by nearly $60 billion. The corresponding increase in U.S. jobs would be approximately 400,000 in 3 years, and $1.2 million in 10 years, according to calculations by Stuart Tucker and myself.

* figures in this section have been revised.

Alternatively, suppose the interest rate "spread" were eliminated on Latin America's bank debt. As a result, more buoyant Latin American markets would be likely to purchase $2-3 billion in additional U.S. exports in the third year, and about $9 billion within 10 years. U.S. employment would jump by roughly 54,000 in 3 years, and 190,000 in 10 years.

Finally, suppose that the banks not only eliminated the interest rate spread, but also wrote down their Latin American debt by 30 percent, to what secondary markets suggest is roughly their true value, at 3 percent a year over a period of 10 years. This "market value" approach to debt relief could boost U.S. exports by an estimated $5 billion after 3 years, and $25 billion within 10 years. The corresponding increase in U.S. jobs would be about 110,000 in 3 years, and 520,000 in 10 years. During the 10 years, this "market value" formula could bolster U.S. exports by a cumulative $120 billion, and U.S. person-years of employment by roughly 2.5 million.

The impact on bank balance sheets of the capitalization approach would depend on Latin American nations' ability to service much larger debts in later years. The present value cost to the banks might be zero. According to the Federal Reserve Board, an elimination of the spreads on Latin American debts would cut pre-tax earnings of 9 money-center U.S. banks by 13 percent and 15 other large regional banks by 6 percent.[8]

Forgiveness of 30 percent of bank debt owed by Latin America could shave off 24 percent of the pre-tax earnings of 15 large regional banks, and could prejudice money-center banks even more, according to the Federal Reserve Board.9 These calculations were based on 1985 earnings, and so may be overly pessimistic. Economists at Salomon Brothers believe that the bright outlook for bank profits could allow large write offs with feasible losses. In a recent report, they project that the major banks could prudently write off nearly 40 percent of their loans to the four major Latin American debtors -- Argentina, Brazil, Mexico, and Venezuela -- without impairing equity ratios.10

No improvement in the debt-trade equation that destabilizes the U.S. banking system would be in the national interest. But there is some room for maneuver. The commercial banks are better positioned today than when the debt crisis broke in 1982, and could absorb a higher proportion of the costs of past mistakes. By concentrating their new business elsewhere, the relative weight of banks' Third World exposure has declined substantially, as a percentage of total assets and of capital. Bank capital in relation to total assets has also grown, and rising dividend payouts reflect the good profitability at most of the major international banks.

Equitable Adjustment

A revised debt strategy that reduces the reverse resource drain is more likely to stimulate adjustment with growth. It would spread the costs of adjustment more equitably among sectors within the United States, and between creditors and debtors. It could improve the U.S. trade position, enhance our leadership role in international economic relations, and improve our diplomatic relations with developing nations.

An equitable adjustment strategy could contain these four measures:

1) Establish target figures for reducing the resource drain that is afflicting many developing nations. The country targets, which could be determined by the World Bank and each debtor nation, should be consistent with reasonable rates of economic expansion. Increased official flows are part of the answer, but there should be a concerted effort to narrow the gap between the interest bill being paid to commercial banks and the amount of new money they are willing to extend. In each country case, creditors can decide whether they would prefer to close that gap by extending new loans or accepting less debt service. Several options for lowering debt service were outlined earlier in my testimony, along with their potential benefits to the U.S.

2) Adopt a genuinely case-by-case approach to debt. Some countries, such as Peru, Costa Rica, Zambia and the Sudan, require debt relief if they are to resume investment and growth. An implicit market differentiation is already occuring, as banks halt lending to such countries and fail to impose legal sanctions even though arrears are accumulating, but this messy arrangement clouds the debtor's economic future. A case-by-case approach should become explicit, and would provide fresh lending to countries where this can lead to renewed creditworthiness, while admitting that some debtors simply cannot carry their existing burdens and grow. It should be noted that most of the countries which are likely candidates for debt foregiveness are carrying very small amounts of the total outstanding debts. Targeting them for special treatment would not destabilize the international financial system, as long as other mechanisms were in place for the major debtors.

3) Safeguard and improve developing countries' trade access to industrial nations' markets. Lowering the reverse resource drain would alleviate some of the pressure on developing countries to run large trade surpluses. But vigorous trade is still necessary if developing nations are to continue some debt service and resume growth. Developing nations that unilaterally liberalize their trade regimes as part of World Bank reform programs should be eligible for reciprocal concessions in the

forthcoming trade negotiations under the General Agreements on Tariffs and Trade (GATT).

4) Make debt resolution and growth in the developing nations a goal of efforts at global economic coordination. Recent efforts by the major industrial nations to stabilize exchange rates and balance macroeconomic policies are laudable, but do not guarantee enough growth, nor sufficiently open markets, to provide developing nations with adequate external stimuli. The IMF staff might generate and publicize indicators of desirable industrial-country performance consistent with global prosperity.

Such an approach could meet the three conditions for overcoming the debt problem. By reducing the net resource drain, by providing a more supportive international environment, and by continuing to foster reforms within developing countries, these measures could redress the weaknesses of the Baker Initiative.

The Congressional Contribution

Both Congress and the Executive Branch have important roles to play in curing the debt disease.

Congress should urge official lenders to marshal their resources to assist nations undertaking sound economic reforms. In 1983, Congress wisely provided the IMF with enhanced resources to tackle the debt problem. Since the IMF has not yet completed its mission to restore many members' financial stability, Congress should urge it to stay engaged. If the World Bank is to provide a significant positive net resource transfer to debtor nations, it will soon need a General Capital Increase. Congress should act swiftly to approve such a request, which will involve a very small budgetary outlay. Similarly, Congress should support the proposed authorizations for the Asian Development Fund and the African Development Bank.

The Congress can help create the public atmosphere in which the commercial banks feel that they ought to play a constructive role. And Congress can work with the regulatory authorities to be certain that federal regulations do not needlessly prevent banks from treating Third World debt with the desired flexibility.

The Congress is currently considering trade legislation that could reduce developing-country exports. Third World nations can pursue export-led growth strategies, and service their debts, only if their major trading partners keep their markets open. A reduction in the reverse resource drain is a better way to improve the U.S. trade balance with debtor nations than trade protectionism.

Finally, Congressional decisions on the U.S. budget have an important impact on global interest rates, capital flows, and growth rates. Responsible fiscal policies in the United States promote economic growth around the world -- which in a virtuous cycle expands markets for U.S. exports and fuels our own economic growth.

Thank you very much.

FOOTNOTES

The views expressed herein are those of the author, and do not necessarily reflect those of the Overseas Development Council. The author would like to thank Mary L. Williamson for her invaluable assistance in preparing this testimony.

1. World Bank, Developing Country Debt (abridged version of World Debt Tables, 1986-87 edition), February, 1987, p.xi.

2. Ibid.

3. U.N. Economic Commission for Latin America and the Caribbean, Preliminary Overview of the Latin American Economy 1986, December, 1986, p.22, table 16; and International Monetary Fund, World Economic Outlook: Revised Projections, October, 1986, p.107, table A50.

4. U.N. Economic Commission for Latin America and the Caribbean, op.cit., p.21, table 14.

5. World Bank, Developing Country Debt, op.cit., p. xiii.

6. IMF, World Economic Outlook, op.cit., p.99, table A45, and p.111, table A52.

7. Stuart Tucker, statement before the U.S. House of Representatives, Committee on Banking, Finance, and Urban Affairs, Subcommittee on International Development Institutions, Washington, D.C., March 19, 1986.

8. Federal Reserve Board, "Illustrative Calculations of Examples of Hypothetical Debt Relief," mimeo., November 5, 1986.

9. Ibid.

10. Salomon Brothers, "Less Developed Countries' Indebtedness: Secular Developments in U.S. Banking are Defusing the Problem," Bank Weekly, January 20, 1987.

Senator BRADLEY. I would like to thank the whole panel for their testimony, and now we will move to questions. Mr. Santiago, I would like you to describe for the committee if you can, what were the fears or the hardships, or what was the situation that sparked the riots last year in Brazilia in November?

Mr. SANTIAGO. In 1986, we had an unfortunate event of a general strike in Brazilia, where we could identify some members of the Ancient Regime (of the dictatorship years), participating in the strikes, breaking buses and setting them on fire, trying to retake their former position and blaming the workers for all that.

We have a concern that we would like to share with you. If the country gets in a recession and if there is no realignment in the country, what we could name the "extremists" would start again, making speeches and causing turmoil and problems in the country. We would not like to see in Brazil what is going on in Peru because for us it is equally evil, a right-wing dictatorship or a left-wing dictatorship.

And if such a thing happens, what we call, the adventurers, with their promises and with their speeches might incite the population to go along with them.

And our main fight is for the final and effective reestablishment of democracy. And if the country keeps plummeting in recession, the strikes are going to increase. And this is not interesting to us. We are interested in economic growth for the country and increased production.

Senator BRADLEY. So, you are saying what you call the pirates, what I translate into as demagogues, take advantage of economic chaos and polarize the society? Is that the general drift of what you said?

Mr. SANTIAGO. Exactly that.

Senator BRADLEY. Yes. Could you give us some sense of why the IMF is no longer able to have a viable role in Brazil?

Mr. SANTIAGO. All the time that Brazil resorted to the IMF, the measures suggested by the IMF were recessive measures: salary and wage freezes, reduction of the massive consumption; and this creates recession. IMF could have a viable role in Brazil if it would change its economic policies.

Senator BRADLEY. Thank you very much. Let's go on to Senator Rockefeller, and then we will come back to questions. We are following the first-come, first-served, early bird rule, Senator Danforth. Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman. Reverend Burns, what was the situation of Felicita and people like her prior to the discovery of this international debt crisis? By that I mean there clearly is a direct relationship because money is siphoned off from social purposes—education and other areas. But one can't draw the conclusion, I guess, that if the international debt situation were solved, that Felicita and her family and her friends and your neighborhood necessarily gain unless truly wise social and public investment is made. In Peru, would that happen?

Reverend BURNS. Well, as much as I would like to be, I am not a prophet; but first of all, the situation in Peru previous to the indebtedness problem and the crisis which started it—incidentally, on July 4, 1976 in Peru—was a struggle—people struggling—and very poor people struggling to make a future for themselves in my parish. I would describe it as a culture of struggle with hope. It has become a culture of survival at this point.

The implementation of IMF policies has a direct relationship in terms of debt, mortality, sickness, in terms of family strength. I am a witness to that, and I have followed that and tried to measure that, which the International Monetary Fund says in one of its first articles is to create jobs and better lives for the people; but they don't have any criteria or indicators in their reports that have anything to do with employment or people—I mean, buying power, et cetera. I mean, there is nothing to indicate individual people; health statistics are not in their reports which shows a sense of interest in the effects.

I would like to say that there is a very clear relationship. A loss in buying power creates malnutrition, which causes sickness, which causes death to children because they are very vulnerable to dehydration. That is very clear; there is no doubt about that. There has been a lack of interest to address that and study it, to look into it and investigate it, up until recently.

To get to the last point of your question, there is no guarantee with a change in policies on the part of the International Monetary Fund that a particular government will be anethescent with regard to its people. The only guarantee is that people participate in societies and are able to participate in a democratic system which will change that situation, other than resorting to violence and some sort of, I would say, hopeless revolution, which would be a bloodbath. So, I think that the present government has improved things slightly.

The situation would have to improve a good deal more in terms of economics to get back to the 1974 levels or the 1975 levels; but it does create conditions in which a democratic system will allow the people to participate, to change the policies of a government, and a government that is more favorable to the interests of the people.

Senator **Rockefeller**. Thank you, Reverend Burns. Mr. Feinberg, if private capital is barely being held in Mexico with interest rates there, and if maintaining private capital in these countries is basic to future development, there have to be certain conditions which will keep that private capital in place and put it to work for the development of the country and the people. What is the threshold, if you can generalize, where capital retention will work economically in these countries.

Mr. **Feinberg**. The simple and short answer is that countries need to maintain an interest rate which is positive in real terms, so that if there is a rate of inflation of 50 percent, nominal interest rates need to be in that range.

Let me suggest that, I think, behind your question about the use of funds lies perhaps a skepticism about the ability of governments to utilize resources efficiently in Latin America. I would argue that there was, in fact, a very good growth rate in Latin America from 1950 to the end of the 1970s.

A number of countries, in fact, did use the foreign capital that they borrowed and kept domestic savings in their country, and Brazil is a fine example of that. Other countries such as Peru did less well. So, there is a wide mix; but even in those countries that didn't do well, I think it has been a learning process. I think that there is a recognition that domestic savings need to be raised, that financial systems have to be improved, that equity markets have to be developed, interest rates kept positive, and that governments have to get along with the private sector.

In the 1960's and 1970's, there was a lot of antagonism between the private sector and governments coming from both sides. You see less of that now; even in Peru, there is a real effort on the part of the Garcia government to work with the private sector. So, I think there has been a very encouraging learning process.

Senator BRADLEY. Thank you very much, Senator Rockefeller. Senator Danforth?

Senator DANFORTH. Question rounds are only five minutes each, so I am going to ask you a very general question and ask if you will respond in turn in about one minute answers.

My question is: What do you want us to do? And if we do anything, what do you think the obligations are of the governments of Latin America? Mr. Burns, would you like to start?

Reverend BURNS. I would say that, from the point of view of my position as a priest, the ethics of the question have to be taken into account. And the most important people in terms of the ethics of the question are the poor.

Senator DANFORTH. I know your underlying view. I got that, but what I want to know is what you would like us to do?

Reverend BURNS. Design a program which takes into account the ethical situation and respond to the poor. I am not an economist. I am not a politician. I would see that we support governments that would respond to those needs in terms of foreign policy.

Senator DANFORTH. Mr. Feinberg?

Mr. FEINBERG. Let me give you a brief summary of my five point program for the Congress. One, official lenders need more resources. The IMF actually has a lot of money—$40 billion they are sitting on. I would urge Congress to urge the IMF to release more of those resources. And then, when the World Bank comes up here—Mr. Connable later in the year or next year for the IBRD—I would urge you also to pass that authorization. Second, I think Congress can do what it is doing here today, which is to create the public atmosphere in which commercial banks feel that they ought to play a constructive role, and Congress can work with the regulatory authorities to see that there is adequate flexibility.

In considering H.R. 3, or the Senate version, Congress can avoid undue protectionism. And then, finally, I don't need to tell you all about the relationship between the budget deficit and the negative impact that that has in Latin America on interest rates and capital flows.

Senator DANFORTH. Do you want to spend more on the World Bank and so on and less on everything else?

Mr. FEINBERG. From the point of view of the U.S. budget?

Senator DANFORTH. Yes.

Mr. FEINBERG. An authorization for substantial increased lending by the IBRD would have a direct budgetary impact on the U.S. Government of a diminutive amount in the neighborhood of a few million dollars because it is leveraged 60 times or more. The paid-in capital is very, very small. And I would venture to even argue that the increase in American exports and therefore American economic activity would funnel back through the revenue side. So, the net impact on the U.S. budget of a small paid-in capital to the World Bank is something that would be unnoticed.

Senator **Danforth**. Thank you. Ms. Colby?

Ms. **Shelton-Colby**. In one minute, Senator, I think there are two things the Congress can do. Assuming that the strategy of the last five years is not going to be viable for the next five years because it is not working—economic growth is not recurring—then I think that we have to assume that there needs to be a change. Now, the banks are not going to take any initiative to reduce the debt service burden unless they are forced to. That pressure can come from two sources.

It could come from any major debtor or debtors and/or it can come from the U.S. Congress because it is not going to come from the Executive Branch, at least in this Administration. I believe that the U.S. Congress could and should encourage the Treasury and the regulators to encourage the banks to do the kind of writing down, capping of interest rates, capitalizing of interest rates, and making further concessions such as, instead of talking about stretching out Mexico's debt for 20 years, stretching it out to 40 years or 50 years. The banks need to be encouraged by the Congress to take the steps that are necessary to get the debt service down to a more manageable level.

And second, the Congress can encourage the regulators to take—15 and basically allow the banks to stretch out their LDC debt as they have already been authorized to stretch out their farm sector and oil sector debts. And just lastly, there is one other thing, very quickly. For those countries like Brazil, which find the IMF politically unpalatable, I would like to suggest an alternative monetary mechanism because I believe very strongly in the need for continued economic adjustment, and there has to be a monitoring mechanism.

I would like to suggest, as Mr. Santiago very articulately described, the reason that Brazil doesn't like the IMF is because it is synonymous with recession. All right. Why can we then not bring in the World Bank to play the lead role in the monitoring process, because the World Bank is synonymous with growth and development? You bring the World Bank in to monitor the Brazilian and other economies, at however many times a year you deem appropriate, and the World Bank could include on its team a couple of personnel from the IMF. The World Bank has the capability. They will say that they don't, but with all those high paid personnel at the World Bank, if they don't have the capability, something is very wrong.

Senator **Danforth**. Thank you. Mr. Santiago?

Mr. **Santiago**. As I said earlier in my speech, it is our understanding that the technical payments of our foreign debt with the current terms that have been imposed on the country is unpayable. We understand that this debt will only be paid if there is an understanding among the democratic nations. There is nothing better than to be in this house, which is the cradle of world democracy, to ask all of you to put some pressure on international bankers to try to solve and minimize the problems of Latin America and Brazil in particular, because it is no use if we are very good exporters of shoes to the United States where we are causing unemployment to the American workers; and the Brazilian worker can't even afford to buy a pair of shoes.

Senator **BRADLEY**. Thank you very much. If we have any further questions, I will just ask one or two, and then we will quickly move through another round if there is a desire.

Mr. Feinberg, could you once more succinctly describe the impact of the debt on job loss in the United States, and from what sources?

Mr. **FEINBERG**. The job loss comes from two factors; one from the actual decline that was observed and then, in addition, you can say, well, if Latin America had been growing instead of declining, there would have been in fact an increase in American exports.

Senator **BRADLEY**. You said that there were 700,000 job losses worldwide, 360,000 related to Latin America or Third World; and then you had another figure, 900,000, which I didn't follow.

Mr. **FEINBERG**. Right. The first effect of the direct decline in U.S. exports resulted in a loss of 630,000 jobs through the Third World as a whole, 360,000 or the majority in the Latin American market. Additionally, if Latin America had been growing from where it was in 1980—moving up instead of down—the part above the line, from the straight line, would have produced an additional 930,000 jobs for the United States.

Senator **BRADLEY**. Related to Latin America?

Mr. **FEINBERG**. That is Third World as a whole. I don't have exact figures for what percentage of that 930,000 would have been in Latin America, but it is safe to say it would be the majority of that 930,000.

Senator **BRADLEY**. Would it be reasonable to say that the same ratio—roughly 40 percent?

Mr. **FEINBERG**. Probably even somewhat higher, given the decline in Latin America.

Senator **BRADLEY**. All right. Thank you very much. Now, Ms. Colby, you gave another statistic, which was the interest paid by Latin American debtors represented as a group—5.3 percent of GDP, gross domestic product—and that the trade surplus that those countries had at that time, during that same period, was 2.3 percent of GDP. Now, what should we make of those statistics?

Ms. **SHELTON-COLBY**. Those are World Bank figures, Senator, not my own. I think the way to explain that is that countries are obviously dipping into savings, and they are dipping into reserves in order to service the external debt. This can go on for a little while, but it can't go on forever.

Conclusion: We need to develop a way of reducing the annual debt servicing.

Senator **BRADLEY**. And what kinds of things do you think the Third World countries themselves need to do?

Ms. **SHELTON-COLBY**. Someone mentioned—I guess it was Richard who mentioned—the economic adjustment that is occurring in Latin America, and I want to reinforce that very strongly. I have been working a lot in Latin America for 19 years, and I have seen a rather staggering change and an attitudinal change in Latin America. It is now difficult to find a Latin American economist or political leader who does not believe in the need for reducing the role of the State in the economy, who does not believe in the need to get the private sector growing again.

And we have seen some quite remarkable changes, as I indicate in my own testimony, in terms of current account deficits reduced, budget deficits reduced, private sector being stimulated, etcetera, etcetera. More of that needs to be done. I would make one final comment. I think Latin America is off on the right track in terms of the economic adjustment process. They need to continue doing more of the same. I agree with Mr. Santiago that the IMF has not always been sufficiently sensitive to the social and political costs of adjustment because the time frame within which they expect adjustment to take place has been too short.

To expect a country to cut its budget deficit in half in the course of one year obviously has social and politically destabilizing effects. So, I think what needs to be done is to borrow or learn a lesson from the Mexico example of last fall in which the creditors agreed with Mexico to a slower pace of adjustment; but nevertheless there is still a renewed commitment to adjustment.

Senator BRADLEY. One last question of Mr. Santiago. Next early fall, Mr. Gorbachev is said to be on his way to Brazil. What do you think he will say about Third World debt?

Mr. SANTIAGO. Before anything, I would like to say that I am not very sympathetic to Mr. Gorbachev, but I would express something that would represent the feelings of the Brazilian workers. We will only be able to afford payments of our assigned debt if the country reaches a total and full democracy. It would be useless for us to be concerned with the State as a whole if we didn't concern ourselves first with the rights of individual citizens.

Senator BRADLEY. Yes. You have successfully avoided the question, as a good politician would, and as I would have if I were in your situation. (Laughter)

Senator Rockefeller?

Senator ROCKEFELLER. Mr. Chairman, I do have questions, but we have two more panels.

Senator BRADLEY. Thank you very much.

Senator Danforth?

Senator DANFORTH. No questions, Mr. Chairman.

Senator BRADLEY. Let me thank the panel very much for your testimony, and I think you have helped us a great deal in our deliberations. The next panel consists of Mr. Steve Beckman, International Economist of the United Auto Workers; the Honorable Sam Brownback, Secretary of Agriculture of Kansas; Mr. James Lee Adams, a soybean farmer of Camilla, Georgia; and Mr. Leroy Watson, Legislative Representative of the National Grange.

Please take your seats. We are a little behind, and we want to hear everyone's testimony and have a chance for questions. This panel will operate on the same schedule as the previous panel. There will be a limitation of five minutes to six minutes on your opening statement, and then we will move directly to questions.

Welcome to the committee. Mr. Steve Beckman of the United Auto Workers, an international economist, you may begin with your testimony. Welcome to the committee, and I appreciate your interest in this subject, and please begin.

STATEMENT OF STEVE BECKMAN, INTERNATIONAL ECONOMIST, UNITED AUTO WORKERS, WASHINGTON, DC

Mr. BECKMAN. Thank you very much, Mr. Chairman. I am appearing here on behalf of the United Auto Workers. We are, as you might imagine, not experts in all of the banking intracacies of this problem. We are not expert in the economic policies of Latin American countries over the last 30 years. But we are aware of the impact that this problem is having on American workers, and especially on our members.

A lot of what I would like to say has already been said. So, I will try to be very brief. Let me start off with some figures that show the interest of the UAW in this issue.

In 1981, prior to the first crisis of Latin American debtors, the UAW had 108,000 members making agricultural implements and construction machinery for companies like Caterpillar, Deere, and J. I. Case. Our membership in these industries has fallen in each year since then, to 53,000 in 1986, a drop of 55,000 members, or 50 percent. Data from the Commerce Department show a decline of 73,000 production workers for the two industries.

While several factors have contributed to this huge employment decline, the loss of exports has played an important role. From 1981 to 1986, U.S. exports of such equipment fell from $13.8 billion to $7.1 billion. Of this $6.7 billion decline, the shrinking of exports to Latin America accounted for $2 billion. In the auto industry, we have seen U.S. exports to Latin America fall from $3.6 billion in 1981 to $1.5 billion in 1983. They have since turned up to $2.7 billion last year, but that is still a level that is 25 percent below the 1981 figure. At the same time, exports of auto industry products from Latin America have grown by more than 400 percent, from $.8 billion in 1981 to $4.2 billion in 1986. This important source of export earnings is certain to grow in the future since both Mexico and Brazil have targetted this industry for further export development.

The U.S. trade balance with Latin America in auto products has gone from a $2.8 billion surplus in 1981 to a $1.5 billion deficit in 1986, contributing to the serious pressure on employment in the industry through this period.

The United States is the primary trading partner for Latin American countries and has been the hardest hit by the cutbacks in Latin American imports and increase in their exports; yet the Administration has no trade policy that addresses the problem of Latin American debt. It supports the repayment of interest and loans in full at current interest rates while hundreds of thousands of American workers lose their jobs because of the trade impact. And the figures that Mr. Feinberg referred to this morning are certainly compelling evidence of the impact on American employment.

This is a serious failing of U.S. trade policy, and it places the entire burden of U.S. adjustment to the policies imposed on debtor countries on workers; and it places that burden not only on workers in the developing countries but, as we have seen, on workers in the United States.

A new Administration policy should demand a fair distribution of the impact of the debt crisis that requires the banks to share in the burden. The Administration must be sensitive to the trade and industrial effects of any developments in world financial markets, and our trade policy should be flexible enough to defend the interests of U.S. producers as international financial conditions rapidly change.

The U.S. should also use its considerable influence in the IMF and other multinational financial institutions to advance the cause of human and labor rights while supporting policies aimed at raising living standards in debtor countries.

The U.S. can be a force for sustaining the progress of democracy in countries like Brazil. Mr. Chairman, it is time for the U.S. to pursue a policy toward Latin America that encourages growth and development for that region which is equitably shared and creates more job opportunities for American workers. This cannot be accomplished by following the present policy of austerity measures and protection for the banks. A policy that is fair to workers in America and to workers in Latin America can be developed and must be developed now.

This hearing is part of that process, and we are extremely anxious to work with you and any other members of this committee or the Senate or the Congress of the United States to arrive at a solution to the serious problems facing Latin America, which do not place the burden entirely on American workers. We are willing to share in that process, but we are not willing to be the only ones paying the price in the United States.

Senator **Bradley**. Thank you very much, Mr; Beckman. Now, let's hear from the Honorable Sam Brownback, the Agriculture Secretary of Kansas. Welcome to the committee, Mr. Secretary; and we are very interested to hear from the heartland on this issue.

[The prepared written statement of Mr. Beckman follows:]

STATEMENT OF
STEVE BECKMAN, INTERNATIONAL ECONOMIST
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

before the
SUBCOMMITTEE ON INTERNATIONAL DEBT
of the
COMMITTEE ON FINANCE
UNITED STATES SENATE

March 9, 1987

Mr. Chairman, my name is Steve Beckman. I am an international economist for the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW). On behalf of the UAW, I want to thank you for holding this hearing on the serious impact of the Latin American debt crisis on the United States. We are pleased that you are providing us the opportunity to represent our views on the impact of the debt crisis on our members and other workers in American manufacturing industries. When the debt problems of Latin American countries are discussed, the mass media's focus of attention has been limited to the impact on banking and financial institutions. We are eager to describe a different perspective on the problem — the loss of U.S. exports and the jobs that depend on them and the increased import competition in the U.S. market and resulting worker displacement that have followed from the current response to the debt crisis. We describe the U.S. government's present policy as "protectionism for bankers"; it has been pursued at the expense of hundreds of thousands of good paying industrial jobs for American workers as well as reduced living standards for workers in the debtor countries.

With the recent announcement of the deferral of debt servicing payments by Brazil, the debt problems of Latin American countries have, once again, become news. It is a particularly important time for this hearing and to report on how American workers have paid a price for the Administration's inadequate response to the debt crisis over the past five years.

Let me start off with some figures that show the interest of the UAW in this issue. In 1981, prior to the first crisis of Latin American debtors, the UAW had 108,000 members making agricultural implements and construction machinery for companies like Caterpillar, Deere and J.I. Case. Our membership in these industries has fallen in each year since then, to 53,000 in 1986. This is a drop of 55,000 members, or 50 percent, in five years. Data from the Commerce Department show a decline of 73,000 production workers for the two industries. While several factors have contributed to this huge employment decline, the loss of export markets has played an important role. From 1981 to 1986, U.S. exports of such equipment fell from $13.8 billion to $7.1 billion. Of this $6.7 billion decline, the shrinking of exports to Latin America accounted for $2.0 billion.

U.S. trade in civilian aircraft has also suffered during the years of austerity in Latin America. Exports fell by 40 percent from 1981 to 1986, and imports have begun to increase. The positive trade balance with Latin America in this important industry dropped by more than half between 1981 and 1986.

Finally, in the auto industry, we have seen U.S. exports to Latin America fall from $3.6 billion in 1981 to $1.5 billion in 1983 before turning up to $2.7 billion last year — a level which is still 25 percent lower than in 1981. Early this year, one of our largest auto export markets in Latin America, Brazil, added automotive vehicles and components to its list of products either barred from import or facing new barriers. The reason for the imposition of new restrictions in January was Brazil's need to generate a larger trade surplus in 1987 than in 1986 in order to meet debt repayment obligations and reduce the need for additional loans. At the same time, exports of auto industry products from Latin America to the U.S. have grown by more than 400 percent, from $.8 billion in 1981 to $4.2 billion in 1986. This important source of export earnings is certain to grow in the future, since both Mexico and Brazil have targeted this industry for further export development. The U.S. trade balance with

Latin America in auto products has gone from a $2.8 billion surplus in 1981 to a $1.5 billion deficit in 1986, contributing to the serious pressure on employment in the industry through this period.

In these four industries together, the U.S. trade surplus of nearly $8 billion in 1981 has nearly vanished entirely. Exports have declined by $3.7 billion and imports are up $3.6 billion. While these and other U.S. manufacturing industries have suffered serious losses in trade with other areas of the world, there can be no doubt that the debt crisis has been the major determinant of this trade pattern with Latin America. The loss of markets in Latin America due to austerity measures has contributed to the many plant closings and layoffs we have experienced in the last five years, especially in auto parts and agricultural machinery.

This is what has happened to U.S. trade with Latin America in the last five years, and it has had a serious adverse impact on hundreds of thousands of American workers — those in industries where the UAW has a large number of members and many others; workers in industries which have lost export opportunities and in industries facing intensified import competition. The question that must be answered is whether this damage to U.S. industrial production and pain for workers is unavoidable or whether alternative U.S. policies could achieve a more positive result for American workers, and, at the same time, recognize and help meet the aspirations of Latin American workers for decent jobs and improving living standards.

First, we must look at the present policies and their impact on the economies of Latin American countries. The debt crisis in Latin America has been, in some cases directly and in others indirectly, managed by the International Monetary Fund (IMF) and the World Bank in conjunction with international banks. These institutions have been supported in their activities by the U.S. government and Administration officials. They have followed what has become a traditional course in debt management situations — debtor nations have been forced to run large trade surpluses to generate the money to pay interest to U.S. and other banks. To accomplish this, imports have been slashed and exports stimulated. Changes in domestic policies, such as the elimination of government subsidies to industries and the lifting of price controls on consumer staple goods, have caused unemployment and dramatic declines in living standards in many countries. Those countries that have resisted such domestic austerity measures have managed to generate trade surpluses without imposing as much hardship on their citizens, but the pressure of debt payment obligations and the IMF's hovering presence are constant threats to their efforts.

The U.S., as the primary trading partner of these nations, has been hardest hit by the cutbacks in Latin American imports and increase in their exports. Yet the Administration has no trade policy that addresses the problem of Latin American debt. It supports the repayment of interest and loans in full and at current interest rates, while hundreds of thousands of American workers lose their jobs because of the trade impact. This is a serious failing in U.S. trade policy. It places the entire burden of U.S. adjustment to the policies imposed on debtor countries on workers.

A new Administration policy should demand a fair distribution of the impact of the debt crisis that requires the banks to share in the burden. The Administration must be sensitive to the trade and industrial effects of any developments in world financial markets. Our trade policy should be flexible enough to defend the interests of U.S. producers as international financial conditions rapidly change.

The U.S. should also use its considerable influence in the IMF and other multinational financial institutions to advance the cause of human and labor rights while supporting policies aimed at raising living standards in debtor countries. The U.S. can be a force for sustaining the progress of democracy in countries like Brazil. Pushing single-mindedly for on-time, in-full debt repayment puts our government on the side of those who place such issues far down on their list of priorities. The result of this approach is what we have experienced for the past five years — worsening economic conditions for workers in Latin America and fewer jobs for American workers.

Mr. Chairman, it is time for the U.S. to pursue a policy toward Latin America that encourages growth and development for that region which is equitably shared and creates more job opportunities for American workers. This cannot be accomplished by following the present policy of austerity measures and protection for the banks. A policy that is fair to workers in America and to workers in Latin America can be developed and must be developed now. This hearing will help to show the need for a new policy. The UAW will be happy to work with you and any other members of Congress interested in making a fresh start toward successfully addressing the Latin American debt crisis.

Thank you, Mr. Chairman, for this opportunity to state the views of the UAW on this important issue.

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Trade in UAW-Related Industries
($ billion)

	1981		1983		1985		1986		Change			
									1981-83		1981-86	
	World	Latin America	World	Latin America	World	Latin America	World	Latin America	World	Latin America	World	Latin America
Civilian Aircraft												
Exports	$13.5	$1.8	$10.7	$0.8	$12.9	$0.9	$14.8	$1.0	-2.8	-1.0	+1.3	-0.8
Imports	3.7	0.1	2.9	0.1	5.9	0.1	7.1	0.2	-0.8	--	+3.4	+0.1
Balance	+9.8	+1.7	+7.8	+0.7	+7.0	+0.8	+7.7	+0.8	-2.0	-1.0	-2.1	-0.9
Construction Equipment												
Exports	$11.6	$3.0	$6.5	$1.1	$6.9	$1.2	$5.7	$1.2	-5.1	-1.9	-5.9	-1.8
Imports	1.0	--	0.4	--	1.3	0.1	1.6	0.1	-0.6	--	+0.6	+0.1
Balance	+10.6	+3.0	+6.1	+1.1	+5.6	+1.1	+4.1	+1.1	-4.5	-1.9	-6.5	-1.9
Agricultural Machinery												
Exports	$2.2	$0.4	$1.5	$0.1	$1.3	$0.2	$1.4	0.2	-0.7	-0.3	-0.8	-0.2
Imports	1.7	--	1.4	--	1.7	--	1.8	--	-0.3	--	+0.1	--
Balance	+0.5	+0.4	+0.1	+0.1	-0.4	+0.2	-0.4	+0.2	-0.4	-0.3	-0.9	-0.2
Automotive (non-Canadian)												
Exports	$7.9	$3.6	$4.6	$1.5	$5.7	$2.8	$5.8	$2.7	-3.3	-2.1	-2.1	-0.9
Imports	19.4	0.8	24.2	1.7	42.1	3.7	53.8	4.2	+4.8	+0.9	+34.4	+3.4
Balance	-11.5	+2.8	-19.6	-0.2	-36.4	-0.9	-48.0	-1.5	-8.1	-3.0	-36.5	-4.3
Total Four Industries												
Exports	$35.2	$8.8	$23.3	$3.5	$26.8	$5.1	$27.7	$5.1	-11.9	-5.3	-7.5	-3.7
Imports	25.8	0.9	28.9	1.8	51.0	3.9	64.3	4.5	+3.1	+0.9	+38.5	+3.6
Balance	+9.4	+7.9	-5.6	+1.7	-24.2	+1.2	-36.6	+0.6	-15.0	-6.2	-46.0	-7.3

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STATEMENT OF THE HONORABLE SAM BROWNBACK, SECRETARY OF AGRICULTURE OF KANSAS, TOPEKA, KS

Secretary **Brownback**. Thank you very much, Mr. Chairman. It is a pleasure for me to be here, representing Kansas farmers; and I am also appreciative of this committee taking its time and effort to look at this situation and how it affects the United States. In particular, my comments will be addressed to how it is affecting Kansas farmers.

It is a matter of great interest to Kansas farmers. As we produce for an export market, we figure generally about one out of every three acres of Kansas farmland production goes into the export market, formerly a great deal of that into Latin American countries—not as much presently.

My written comments have been submitted. I will try to put them succinctly forward. There is actually a great deal in common between the Latin American countries and the Kansas and American farmers. In Latin America, the developing countries incurred in the neighborhood of $800 billion in debt through the 1970s, the U.S. farm debt was over $200 billion during that same time period. We borrowed; we borrowed heavily. Inflation was generally on our side during that time period.

We were told to borrow and produce off of that, the money was free-flowing, and we did. We incurred a great deal of debt, and as I have stated, it got well up over $200 billion in U.S. farm debt. It has presently worked its way down to below $200 billion at the present time. I believe the figure I have seen most recently is somewhere around $180 billion from that pinnacle of over $220 billion.

So, U.S. farmers and Latin American countries are caught in much of the same situation. Latin America must increase exports and decrease imports; U.S. farmers must increase sales and decrease costs. Normally, we in the United States in the farm and agricultural sector will look to developing countries for market growth to export our bulk commodities.

In Dr. Robert Parrberg's booklet and study on "U.S. Agriculture in the Developing World, Partners or Competitors," he notes that that is normally the situation, where we get most of our growth in exports to developing countries for food bulk commodities. However, he notes an exception in Latin America, and I cite this in page 2. I will read this quote.

"Joint gains between U.S. and Latin farmers have also been blocked because agriculture in Latin America has been oriented more toward earning foreign exchange through exports and less toward producing domestic employment and income growth," which is normally where the developing countries grow—in their farm sector—and thus, as they improve their standard of living, they generally import more feed grains to feed livestock with, more soybeans to supplement the protein in that diet. So, we are seeing an abrogation in a normal developmental policy in Latin America versus the rest of the developing world.

Our exports have fallen. Kansas farm exports have fallen significantly—generally one-third to 40 percent—from 1981 to 1985, due in part, clearly, to the Latin America situation.

Even more troubling to me, is the amount our imports of food have increased in this country. We import into the United States over $20 billion worth of foodstuffs a year! In 1981, we had a net food export, a balance of trade to the plus side, of $27 billion. In other words, we exported $27 billion worth of food more than we imported. In 1985, it was $11 billion.

We are importing so much more food, this is very troubling to me, it is troubling to Kansas farmers that in a nation of bounty, oversupply and surplus, we import so much food much of it from Latin America, while they starve.

I note on page 3 of my testimony a specific example of a breeding stock situation, where we used to export considerable amounts to Mexico and Latin American countries, and they would build up their herds; and we feel, by that means, would increase their demand for feed substances, feed grains.

They would buy to improve their herd sire, paying $1,500 to $2,000; and now, if they even have the currency, they are buying just weaned fall calves at $500 to $600 in the hopes that that calf will be what the proven sire already was shown. It hurts them; it hurts us.

It is striking to me that the difference of how the large banks versus the small rural banks differ in dealing with the debt problem. We have been going through a very difficult time down on the farm, in readjusting and dealing with our debt problems. What has happened is the rural banker is going to the farmer, or the farmer is coming into him, and saying, look, I can't pay the debt; there is no way I can see my way out of this. What are we going to do together? And together, in many rural situations, the rural bank is saying, okay, let's see if we can write down part of this. Can we decrease the interest? Can we stretch it out over time? Trying to keep that farmer there and operating so that the farmer can stay on the farm, and the bank can get more in the long run.

That is generally what is happening in a lot of rural banks across the State of Kansas: they work with their debtor, stretching out and decreasing payments. I question why that can't happen with the Latin America debt. Although I am certainly not an economist to project those sorts of things; but it seems to work well and is working in the rural situation.

Finally, we have to question a little bit the morality of the situation, where we cause countries, where they have starving people, to export food to a country that has an oversupply of food. Kansas farmers and myself are indeed proud of the "Green Revolution" that Dr. Norman Borlog had started in developing new strains of wheat and other varieties for developing countries so that they could feed themselves—during the 1960's—and they had tremendous growth in food in those countries.

Yet, now, rather than using that food to feed themselves, they are putting it on the world export market that already has a glut—an oversupply—of food; and we wonder very much about the morality of that as it affects both Latin American farmers, Latin American countries, and U.S. and Kansas farmers.

Mr. Chairman, I will stand for questions.

Senator **Bradley**. Thank you very much, Secretary Brownback. Now, let's hear from Mr. James Lee Adams, who is a soybean farmer from Camilla, Georgia. Mr. Adams, welcome to the committee, and I look forward to hearing your special perspective.

[The prepared written statement of Secretary Brownback follows:]

SAM BROWNBACK

KANSAS SECRETARY OF AGRICULTURE

Kansas is a great agricultural state. Our land, our climate and our people seem worlds apart from the developing nations of Latin America.

Yet our state and the countries of Latin America are world neighbors. Our grain and livestock farmers and the campesino farmers of Latin America have much in common today.

Both are suffering as the result of massive debt which they were encouraged to accumulate in the 1970s.

The collective debt of the world's developing countries is more than $800 billion.

The U.S. farm debt, at $200 billion, is one-fourth that of all the developing countries combined.

The developing countries and the American farmers were following acceptable behavior when they incurred that record debt in the 1970s. And it seemed, for a while, to be working. Debt-financed growth raised per capita income in many Latin American countries. For American farmers, high land values, high commodity prices and ever-increasing export markets made it logical to borrow to increase production. American farm exports and profits grew.

But then the rules changed.

After the second round of oil price hikes in 1979-1980, the availability of credit declined. The demand for American commodities from developing nations declined. International commodity prices declined. Third World countries had to find a way to raise money to buy oil and to service their huge debts. They were encouraged to do that by increasing exports.

The American farmer and the Latin American countries are caught in the same destructive cycle. Latin America must cut imports and increase exports to pay off debts. American farmers must do the same. International commodity prices are driven lower by increased supply and decreased demand.

In "United States Agriculture and the Developing World: Partners or Competitors?", Dr. Robert L. Paarlberg says: "Joint gains between U.S. and Latin farmers have also been blocked because agriculture in Latin America has been oriented more toward earning foreign exchange through exports and less toward producing domestic employment and income growth."

Kansas has only one percent of the U.S. population, but a great productive capability. It must export to survive, and in recent years, exports have been responsible for nearly a third of the state's cash receipts in agriculture.

As the Wheat State, Kansas easily leads the nation in production of hard red winter wheat. Production far outstrips domestic consumption, so export markets are vital to Kansas wheat farmers.

In 1981, Kansas exported wheat and flour worth $1.34 billion. In 1985 that figure had dropped more than 40 percent to $797.3 million.

Our next leading crop is a feed grain, sorghum. In 1981, our exports of all feed grains, including sorghum and corn, were valued at $497.7 million. In 1985, they had dropped to $372 million, falling 25 percent.

Exports of another important crop, soybeans, dropped 26 percent, from a value of $107.4 million in 1981 to $78.8 million in 1985.

Total Kansas exports declined 24 percent between 1981 and 1985.

The prices our farmers receive have fallen from over $4 a bushel for wheat and over $3 for corn in 1981 to $1.44 for wheat and $2.17 for corn in 1986.

A financial survey undertaken early in 1986 indicated that nearly six percent of Kansas farmers felt they would be forced to leave the farm that year. The average debt-to-asset ratio for surveyed Kansas farmers was 31.8; 12.5 percent of them had debt-to-asset ratios over 69.

The suffering and social problems caused by this situation cannot be conveyed by the use of statistics.

Cattle provide the largest contribution to our state's agricultural economy[1]. Years have been spent working to increase the export of breeding stock to Latin American countries, but present conditions make it almost impossible for their buyers to purchase our products. According to Kansas State University's International Livestock Program, many Kansas producers want to export, but Mexican buyers, for example, can barely afford to exchange pesos at the current rate to buy American livestock. Buyers who still are able to come to Kansas no longer can pay $1,500 to $2,000 for a proven herd bull but now are looking at just-weaned fall-born calves for $600. The debt service plans which have been forced on them keep them from helping themselves and us.

Existing ways of dealing with the Latin American debt problem--from the Baker Plan, the International Monetary Fund and the World Bank--only aggravate the problem. By loaning the indebted countries even more money, they have encouraged increased exports to generate capital to service debts to the money center U.S. banks. Latin America's forced increased exports decrease our farmers' exports and lead to a continuous cycle of falling commodity prices world-wide. This takes both American farmers and the Latin American nations even further from the possibility of servicing their debts. And this while the people of Latin America go hungry.

As a resident of a state with many small town agricultural banks, it seems very strange indeed that there are such different rules for the rural banks and the large, multinational banks. Rural Kansas banks would find it difficult to survive if their response to farmers who could not pay their loans was to loan them even more money they could not repay. Some might even find that downright silly. Rather, rural Kansas banks find it necessary to renegotiate those troubled loans, to find a way for the farmer to reduce, rather than increase debt. It helps the farmers continue producing and the banks collect more in the long run. It also helps the hundreds of Kansas communities which depend on agriculture to survive.

It seems logical to me that the large multinational banks should respond to debtor nations in a similar way; however, their response seems to be to throw good money after bad, increasing the debt and the banks' profits along the way, but almost guaranteeing that the cycle of falling commodity prices and social and political turmoil in the debtor nations will continue. The livelihoods of the Kansas farmer and the Latin American campesino alike are being abridged by policies which are counter-productive to democratic and economic development in Latin America. This is not what I call being a good member of the world community.

The Latin American debtor nations have reduced their imports from $100 billion in 1981 to $60 billion today. The three largest debtor nations increased their exports by 47 percent for Argentina; 56 percent for Brazil and 62 percent for Mexico. Yet commodity prices continue to drop, Mexican real wages are back at 20-year-ago levels and malnutrition and disease are increasing in Latin America. It seems the only status quo is maintained by the multinational banks which have maintained and even increased profitability. But global over-production cannot continue forever.

Apart from the financial pressures, I must question the morality of a policy which encourages exports at the cost of human suffering both in Kansas and so desperately in Latin America.

A Kansan concerned about the Latin American debt told me of a political cartoon which appeared in the popular Brazilian magazine, "Interior," in January 1985. One does not have to understand Portuguese to understand the message in the drawing which shows a starving Brazilian farmer watching a shipload of protein-rich soybeans leave the port for export.

A report from Sao Paulo, Brazil, indicates that the number of malnourished Brazilian children has increased by 23 million over the past 10 years. What effect do 23 million starving children have on the social and political structure of struggling young democracies? Again, I question the morality of an International Monetary Fund adjustment program which forces debtor nations to restrict domestic food consumption in order to produce food for export in a world with a global food surplus.

Americans were justifiably proud of the Green Revolution which taught the people of Third World nations to grow their own food. We shared technology to help them help themselves by feeding themselves. How ironic that we now are forced to compete with that same technology in agricultural export markets--yet the people of Latin America are still starving.

We must find new and innovative ways to solve the Latin American debt crisis. The Kansas farmer and the Latin American campesino have very nearly equal stakes in that solution.

I believe the Bradley plan is a positive step toward resolution of a problem which threatens us all. It provides a compromise between the Latin American countries and the banks by cutting interest rates and writing down principal. It is a shared solution to a shared problem.

As the rural banks of Kansas understand they share a rural way of life with their rural customers, they realize they also share responsibilities for each other's survival. So should North Americans realize their responsibilities to and their interdependence with their Latin American neighbors. We have a moral responsibility to fight poverty in Latin American countries, rather than bleeding corporate profits from human misery. In the long run, it cannot help but be a mutually beneficial relationship between the Latin American farmer and the Kansas farmer. We live in a global neighborhood, and if we continue to ignore the interdependence between the United States and the debtor nations, we ignore the wellbeing of U.S. citizens as well as Latin Americans.

STATEMENT OF JAMES LEE ADAMS, JR., CAMILLA, GA

Mr. ADAMS. Thank you, Mr. Chairman. I also serve as Vice President of the American Soybean Association, an organization that represents 419,000 farmers nationwide.

Mr. Chairman, I am pleased to have the opportunity to testify before this International Debt Subcommittee this morning. The Third World debt is a pressing issue for U.S. agriculture, particularly the debt held by Latin American nations which export soybeans and soybean products in direct competition with American soybean farmers. We also are not experts in international banking, but we are able to testify as to the adverse impact the debt crisis has had on rural America. Current policy has resulted in the innocent, both home and abroad, paying for the guilty to make profits.

The 1982 Mexican bailout set the stage for the IMF, private bank, and industrial nation policy toward large debtor nations: export more, import less, to earn hard currency with which to pay the debt. But these exports were often agricultural commodities—in the case of Brazil and Argentina—soybean exports directly competing with U.S. soybeans. Latin America has always been a major market for U.S. agricultural exports. In 1981 it was the third largest, but since the debt crisis hit in 1982, the value of our agricultural exports to major debtor nations has plummetted.

While the value of total agricultural exports to Latin America fell 32 percent between 1981 and 1985, the percentage decline in the value of U.S. farm exports to most Latin American debtors during the same period was as great and usually greater. For example, the value of farm exports to Brazil fell 34 percent. The value of farm exports to Argentina fell 61 percent; to Mexico, 41 percent; to Venezuela, 40 percent.

While falling commodity prices have no doubt accounted for part of the decline in export value, the austere import policies adopted by these debtor nations at the command of IMF have also cut down on the volume of U.S. farm exports to the major debtors. Brazil, the largest debtor in both size and amount of debt, between 1982 and 1986 reduced by 76 percent its imports of wheat, flour, and other products from 2.6 million metric tons to 612,000 metric tons. Brazil is also a major U.S. export market for these commodities.

Mexico has also sharply reduced wheat and flour imports from the United States by nearly 100 percent between 1982 and 1986, from 398,000 metric tons in 1982 to 110 metric tons in 1986. During this same period, Mexico cut back on imports of other major U.S. agricultural commodities as well. Soybean oil imports from the United States fell 19 percent from 46,000 metric tons to 37,000 metric tons. And just as a comment, I don't think we could make the assumption that their quality of living has risen in that period of time as far as being able to have a better standard of living as far as what they are eating.

Besides reducing the imports of U.S. farm commodities, Latin American debtors have significantly stepped up exports of agricultural commodities to the U.S. and Third World country markets. Brazil and Argentina have developed their soybean interests just to the point where the two nations combined have accumulated significant shares of the world's export markets for soybeans and soybean products.

For example, in 1979 the United States accounted for 41 percent of all the soybean meal exports, while Brazil and Argentina combined had a 32 percent share. Beginning in 1980, the South American market share surpassed ours; and by 1985, Brazil and Argentina had 47 percent of the world market while we had less than 25 percent.

In 1979, U.S. soybean oil accounted for 37 percent of total world soybean trade, while Brazil and Argentina soybean oil had less than a 20 percent share. But by 1985, the South Americans' share approached 34 percent while our share was 18 percent. In 1979, the United States had 84 percent of the world soybean market, and Brazil and Argentina accounted for 12 percent. In 1985, the U.S. market share was down to 77 percent, and South America is up to 15 percent.

In short, Brazil and Argentina now occupy the same position of dominance in soybean product trade that the United States once held. U.S. soybean farmers believe the heavy debt burden of many Latin American nations is one significant reason for exploding South American production.

While these nations' debt burdens have indeed had a negative effect on U.S. farm exports to Latin America, U.S. soybean farmers believe that the debt-directed strategy followed by the Latin American debtors has injured the economic health of these nations.

Most Latin American nations have suffered declining standards of living. Latin Americans' GDP growth rate fell from 5.3 percent in 1980 to a negative 2.5 percent in 1983. Between 1980 and 1985, the average Latin American GDP growth rate was 1.3 percent. Between 1981 and 1982, Chile's unemployment rate rose 11 percentage points to a staggering 20 percent, and has remained near that percentage since.

Latin America's notorious inflation rates have run rampantly since 1981.

We soybean farmers advocate a policy which encourages debtor nations to satisfy domestic demand, which has been stifled by current debt policies of creditors, and to continue economic growth. A policy such as debt forgiveness in exchange for debtor nations listing import restrictions to their markets would benefit both U.S. farmers and the populations of these impoverished countries. Debtors could use the foreign exchange they otherwise would have used to pay interest on their foreign debt for domestic growth, rather than debt service. U.S. farmers and exporters would have access to new markets and relief from export competition driven by debt service needs rather than market signals.

ASA has prepared a comprehensive report on the impact of the Latin American debt on U.S. agriculture. That report is attached to the written copies of my testimony, and I highly recommend it as a further reading on this issue.

Thank you once again for the opportunity to testify.

Senator BRADLEY. Mr. Adams, thank you so much for your testimony. Now, Mr. Leroy Watson, Legislative Representative of the National Grange. Mr. Watson, welcome to the committee.

[The prepared written statement of Mr. Adams follows:]

TESTIMONY OF
JAMES LEE ADAMS
VICE-PRESIDENT
AMERICAN SOYBEAN ASSOCIATION

BEFORE THE
SENATE FINANCE INTERNATIONAL DEBT SUBCOMMITTEE

MARCH 9, 1987

Mr. Chairman, my name is James Lee Adams. I'm a farmer from Camilla, Georgia, where I farm 2,500 acres of land, 400 of which are devoted to soybeans. I serve as vice-president of the American Soybean Association, a national non-profit organization of over 20,000 dues-paying members and approximately 419,000 farmers who support our activities through voluntary state assessment programs.

Mr. Chairman, I'm pleased to have the opportunity to testify before the International Debt Subcommittee this morning. Third World debt is a pressing issue for U.S. agriculture, particularly the debt held by Latin American nations, which export soybeans and soybean products in direct competition with American soybean farmers.

When I plant my beans this spring, almost one out of every two rows will go into the export market. Nearly one-half of the United States' 2 billion bushel soybean crop is exported each year. My concern with U.S. soybean export markets, as you can understand, is considerable.

To briefly review the history of the debt crisis ... Latin American nations borrowed recycled petrodollars in the 1970s to fund economic growth in the face of increasing oil prices. However, industrial nations' disinflation in the early '80s brought many of these nations to the brink of disaster through rising interest rates on their foreign debt and falling commodity prices, which meant falling export revenues for debt repayments.

The 1982 Mexican bailout set the stage for IMF, private bank, and industrial nation policy toward large debtor nations: export more and import less to earn hard currency with which to pay the debt. But those exports were often agricultural commodities -- in the case of Brazil and Argentina, soybean exports directly competing with U.S. soybeans.

Latin America has always been a major market for U.S. agricultural exports. In 1981, it was the third largest. But since the debt crisis hit in 1982, the value of our agricultural exports to major debtor nations has plummeted. While the value of total agricultural exports to Latin America fell 32% between 1981 and 1985, the percentage decline in the value of U.S. farm exports to most Latin American debtors during the same period was as great -- and usually greater.

For example:

- the value of farm exports to Brazil fell 34%
- the value of farm exports to Argentina fell 61%
- the value of farm exports to Mexico fell 41%
- and the value of exports to Venezuela fell 40%

While falling commodity prices have no doubt accounted for part of the decline in export value, the austere import policies adopted by these debtor nations at the command of the IMF have also cut down on the volume of U.S. farm exports to the major debtors.

- Brazil, the region's largest debtor in both size and amount of debt, between 1982 and 1986 reduced by 76% its imports of wheat, flour, and other products, from 2.6 million metric tons to 612,000 metric tons. Brazil is a major U.S. export market for those commodities.
- Mexico has also sharply reduced wheat and flour imports from the United States ... by nearly 100% between 1982 and 1986, from 398,000 metric tons in 1982 to 110 metric tons in 1986. During this same period, Mexico cut back on imports of other major U.S. agricultural commodities as well. Soybean oil imports from the United States fell 19%, from 46,000 metric tons to 37,000 metric tons. Poultry and poultry products imports from the United States have fallen 47%.
- U.S. exports of coarse grains to Venezuela fell 30% between 1982 and 1986 -- from 930,000 metric tons to 655,000 metric tons.

Besides reducing their imports of U.S. farm commodities, Latin American debtors have significantly stepped up exports of agricultural commodities to the United States and other third country markets. There was a time when the United States completely dominated world soy trade. Those days are gone. Brazil and Argentina have developed their soybean industries to the point where the two nations combined have accumulated significant shares of the world's export markets for soybeans and soybean products. For example:

- In 1979, the United States accounted for 41% of all soybean meal exports, while Brazil and Argentina combined had a 32% share. Beginning in 1980, the South American market share surpassed ours, and by 1985, Brazil and Argentina had 47% of the world market while we had less than 25%.
- In 1979, U.S. soybean oil accounted for 37% of total world soyoil oil trade, while Brazilian and Argentine soybean oil had less than

a 20% share. But by 1985, the South Americans' share approached 34% while the U.S. share was only 18%.

- In 1979, the United States had nearly 84% of the world soybean market, and Brazil and Argentina accounted for 12%. In 1985, the U.S. market share had shrunk to about 77% with our South American competitors taking 15%.

In short, Brazil and Argentina now occupy the same position of dominance in soybean product trade that the United States once held. Our position in the soybean market itself, though still dominant, is nowhere near what it once was. U.S. soybean farmers believe the heavy debt burden of many Latin American nations is one significant reason for exploding South American production.

While these nations' debt burdens have indeed had a negative effect on U.S. farm exports to Latin America, U.S. soybean farmers believe that the impact on these debtor nations' economies has been just as negative and should also be addressed. The "debt-directed" strategy followed by the Latin American debtors has injured the economic health of these nations and undermined the political stability of the region.

Most Latin American nations have suffered declining standards of living. Latin America's GDP growth rate fell from 5.3 percent in 1980 to a negative 2.5 percent in 1983. Between 1980 and 1985, the average Latin American GDP growth rate was 1.3 percent. Argentina's unemployment rate has soared since 1980 -- up 4 percentage points to 6.6 percent in 1985. Between 1981 and 1982, Chile's unemployment rate rose 11 percentage points to a staggering 20 percent and has remained near that percentage ever since. Latin America's notorious inflation rates have run rampantly since 1981. The average rate of price increases in the region's economies rose from 57.6 percent in 1981 to 328.3 percent in 1985. Argentina, Peru, and Brazil posted inflation rates well over 150 percent in 1985.

A leading Brazilian agronomist recently reported that per capita production of such domestically consumed products as rice, black beans, manioc, and potatoes fell 13% between 1977 and 1984, while per capita production of agricultural exports such as soybeans, oranges, cotton, and peanuts rose 15 percent.

Health conditions in these nations have also deteriorated. According to the Pan-American Health Organization, Brazil's difficulties in servicing its foreign debt have worsened the living conditions of most of the population and constrained access to such essential services as food, housing, education, and health. One-third of Brazil's population is estimated to be without regular access to health care services; more than one-half of expectant mothers receive no prenatal care of any type. In Mexico, public health expenditures as a percentage of GDP have fallen significantly, from 2.1% in 1978 to 1.6% in 1983.

The foreign debt of many Latin American debtors threatens the democracies in a region traditionally dominated by the military. Since 1979, democracies have been established in 10 Latin American nations, including such debtors as Brazil, Argentina, Peru, and Ecuador. Brazil and Ecuador, you might note, have in the past month suspended debt repayments to give their squeezed economies some space to grow. Popular unrest because of economic austerity programs threatens democratically elected Latin leaders in nations where the military's presence is everywhere, and where Communists are just waiting in the wings for the chaos they need to flourish. Peruvian President Alan Garcia in 1985 aptly stated the situation when he announced that Peru would limit its interest payments to 10% of exports earnings in a choice between "debt and democracy".

For the reasons I have just cited, American soybean farmers believe current U.S. policy toward the foreign debts of Latin American nations has lacked foresight of its serious effects on the economies of the United States and Latin debtors. Furthermore, new proposals such as the Baker plan, which calls for fresh loans to debtor nations, will not relieve the economic and political pressures in these countries.

U.S. soybean farmers advocate a policy which encourages debtor nations to satisfy domestic demand, which has been stifled by current debt policies of creditors, and to continue economic growth. A policy such as debt forgiveness in exchange for debtor nations lifting import restrictions to their markets would benefit both U.S. farmers and the population of these impoverished nations. Debtors could use the foreign exchange they otherwise would have used to pay interest on their foreign debt for domestic growth, rather than debt service. U.S. farmers and exporters would have access to new markets, and relief from export competition driven by debt service needs rather than market signals.

The American Soybean Association has prepared a comprehensive report on the impact of the Latin American debt on U.S. agriculture. That report is attached to the written copies of my testimony, and I highly recommend it as further reading on this issue. Thank you once again for the opportunity to testify.

THE LATIN AMERICAN DEBT SITUATION AND U.S. AGRICULTURE

AMERICAN SOYBEAN ASSOCIATION

INTRODUCTION

Latin American debt has directly or indirectly affected everyone in the United States. While this report focuses on its impact on U.S. agriculture, most industries that trade with Latin America have felt the effects of debtor countries' adjustment to the world economy of the 1980s. The response of the International Monetary Fund (IMF), the U.S. Administration, and the commercial banks to the 1982 Mexican debt crisis was unprecedented in global finance in its degree of international cooperation and planning. Unfortunately, that response has shown little foresight for the magnitude of its repercussions on both creditor and debtor nations.

These repercussions are behind this report and an increasingly heated debate about a new policy approach to the Latin debt situation. A wide range of U.S. interests and industries are demanding recognition of the share of the adjustment burden they have born because of debtor nations' austerity programs. Furthermore, evidence is strong that the basic assumptions of current policy and such proposals as the Baker plan are flawed. A new U.S. initiative on international debt must consider all affected interests, particularly American agriculture, or it is bound to satisfy none.

HISTORY

Origins

The debt servicing difficulties experienced by many Latin American nations since 1982 are rooted in several developments in the international economy that occurred in the 1970s. The traditional explanation links the 1973 oil price hike and the resulting increase in OPEC nation liquidity (so-called "petrodollars") with the rise in bank loans to certain developing nations. International banks played the important intermediary role of accepting OPEC nation deposits and, in turn, lending out these deposits to "creditworthy" developing nations. This "petrodollar recycling" enabled most oil-importing, developing nations to weather the severe drain on their treasuries caused by the oil price rise without sacrificing economic growth and development.

Several factors made such loans attractive to both the banks and the borrowing nations. From the Latin American point of view, bank loans were the best means to obtain capital with no strings attached, unlike World Bank financing or foreign investment by multinational corporations. A depreciating dollar and low or negative real interest rates caused by worldwide inflation also added to the attractiveness of commercial bank financing by undermining the value of the debt. From the commercial banks' side, the rising prices of raw materials exported by Latin American nations made these nations appear to be excellent credit risks.

shortages that have been the immediate cause of the debt crisis. Unlike U.S. farmers, the nine major U.S. money center banks have, with a few exceptions, made money since 1982. Morgan Guaranty, for example, posted a 79 percent profit increase between 1982 and 1985.

An analysis of current and proposed policy approaches to the debt crisis must necessarily evaluate the effects on those involved. Current policy has failed to bring prosperity to any sector but banking. U.S. farmers and exporters have been equally injured. Furthermore, the Administration's 1985 proposal to address the worsening debt crisis makes the same mistakes as current policy. The "Baker Plan" would increase official and private lending by $29 billion over 3 years in exchange for market-oriented economic reforms undertaken by the debtors. More debt doesn't beget less debt. The Latin debt situation is a long-term problem and must be dealt with in the framework of a long-term approach. Short-term bandaids such as the Baker plan will likely be ineffective in successfully lowering the debtors' burden over the long run. Furthermore, such bandaids have only heightened the bleeding of American agriculture.

With this in mind, U.S. officials must seek new approaches to the international debt problem. Senator Bill Bradley's concept of debt relief is one such approach. Bradley proposes reducing interest rates on all commercial and official bilateral loans to eligible debtors by 3 percent over 3 years, and annually writing off 3 percent of the loan principal over the same period. He also proposes a modest increase in lending to the eligible countries. Bradley's plan imposes a share of the burden of the debt crisis on the major banks, which have vehemently objected to the plan. Other debt-relief schemes have also recently come to light. Debt-for-equity swaps afford multinational corporations the chance to make bargain-rate equity investments in debtor nations by buying that nation's foreign debt at a discount. Requiring commercial banks to value foreign loans at their market value as reflected in a growing secondary international loan market would facilitate debt-for-equity swaps and write-down a fair amount of debt--Steve Hanke's "truth-in-banking" proposal. Senator Paul Sarbanes and Representative David Obey have suggested establishing a special debt facility to purchase and restructure Third World loans.

From the standpoint of U.S. agriculture, the best solution to the international debt crisis is one which conditions a systematic write-down of Latin American debt upon the designated countries' adoption of specific policies. Such policies include eliminating import barriers and export subsidies, and diverting a greater share of domestic production of food and fiber for internal consumption. Debt relief could also be a U.S. bargaining chip in the upcoming Uruguay Round of GATT trade negotiations to gain trade concessions from protectionist debtors.

The U.S. government must face the reality of the toll the Latin debt crisis has taken on U.S. agriculture. Legislators and U.S. government officials must act swiftly and decisively.

Furthermore, loans to developing nations were usually more profitable than those to domestic borrowers. Not only were Latin American nations willing to pay more to borrow from commercial banks, but the absence of reserve requirements for U.S. dollar deposits--Eurodollar deposits--held by international banks and foreign branches of U.S. banks allowed these financial institutions to lend at lower rates of interest, while still reaping a huge profit.[1]

Finally, the development of floating-interest-rate loans enabled banks to make long-term loans without incurring the risk associated with "maturity transformation"--accepting short-term deposits while making longer-term loans at higher rates of interest. The interest rate on a floating-rate loan was adjusted regularly with changes in the rate paid on six-month deposits of U.S. dollars in foreign banks, known as LIBOR--the London Inter-Bank Offer Rate. Thus, commercial banks could make loans maturing in six to ten years without undertaking the risk that short-term deposit interest rates would rise above the rate paid on long-term loans. Developing nations were generally the only borrowers willing to take on the risk of floating-rate loans.[2]

The 1982 Crisis and Beyond

The 1982 debt crisis began with a changed world economy brought about by the industrial countries' disinflationary policies in the first years of the 1980s. When the United States decided to fight oil-price driven inflation in 1979, the resulting economic contraction reverberated worldwide. Interest rates shot up, and the rates on the floating-rate loans of the debtors accordingly followed. Falling commodity prices and worldwide recession reduced the debtors' export volumes and revenues--Latin American terms of trade fell 7.6 percent in 1981 and 8.9 percent in 1982.[3] The Latin American debtors, by 1982, were faced with difficult economic and political choices in dealing with their foreign debts.

With a few exceptions, most of the debt problem in 1982 was concentrated in Latin America (see Table 1). The region's debt rose from $241.6 billion in 1980 to $330.5 billion in 1982--almost a 40 percent increase. In 1982, the combined foreign liabilities of the four highest-debt Latin American nations, Brazil, Mexico, Argentina, and Venezuela, constituted 31 percent of the external liabilities of all developing nations and 76 percent of the total debt of all nations in Latin America and the Caribbean.[4] These four nations' total debt service (actual payments of interest and principal) on public and publicly guaranteed debt ranged from $28 billion to $34.6 billion between 1981 and 1984 (Table 2). Twenty-one of the 27 countries requesting commercial bank debt renegotiation during 1981-1983 were Latin American.[5]

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[1] Alfred J. Watkins. Till Debt Do Us Part. (Lanham, Maryland: University Press of America, 1986), pp. 19-25.

[2] Ibid, pp. 26-27.

[3] United Nations Commission for Latin America and the Caribbean, Preliminary Overview of the Latin American Economy, 1985 (Santiago: ECLA, December 1985), Table 9.

A resolution to the 1982 crisis was especially critical for U.S. banks, which held more than 25 percent of Latin America's total debt and one-third of the debt owed to private creditors. At the end of 1982, nine money center banks' total exposure in Latin America was 176 percent of their combined capital. According to a recent Joint Economic Committee study, if the Latin American nations had defaulted on only 20 percent of their outstanding debt, these money center banks would have lost more than 35 percent of their combined capital[6].

Mexico's 1982 announcement of its inability to repay interest on its foreign debt set off a scramble in government and banking circles to shore up a failing Mexican economy and develop new policies designed for a changed world economy. It soon became apparent that Mexico was only one among many debtor nations facing difficulties in interest repayments. As a result, the Mexican bailout package fashioned by the U.S. government, the International Monetary Fund (IMF), and the commercial banks has since been a model for coping with the foreign debt of other borrower nations.

The commercial banks and the IMF, for the first time in history, collaborated in developing nation debt matters. The needs of ailing debtors far exceeded the resources of the IMF, while the commercial banks had neither the IMF's facilities to expertly assess foreign nations' economic conditions nor the political clout to ensure compliance with economic stabilization programs. Out of this alliance was born the strategy to restore debtor nation debt-servicing capability, which consisted of four parts:[7]

- debtor nations would increase exports and slash imports to generate foreign exchange to make interest payments
- loans would be restructured to extend the time for repayment
- new commercial bank loans would be made
- the IMF would oversee economic reform programs to implement necessary changes in debtor nation economic policies

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[4] World Bank, World Debt Tables: External Debt of Developing Countries, 1985-86 Edition (Washington, D.C.: The World Bank, March 1986), p. xi.

[5] David Stallings, "Debt in the Less-Developed World," Agricultural Outlook (July 1984): p. 22.

[6] U.S., Congress, Joint Economic Committee, The Impact of the Latin American Debt Crisis on the U.S. Economy, staff study prepared for the Joint Economic Committee. 10 May 1986, pp. 1-2.

[7] Ibid., pp. 2-3.

TABLE 1

LATIN AMERICA AND THE CARIBBEAN: GROSS EXTERNAL LIABILITIES PLUS HIGHEST-DEBT NATIONS, 1980-1985
(Billions of dollars)

Country	1980	1981	1982	1983	1984	1985*
Latin America and Caribbean	241.6	293.4	330.5	354.0	372.9	383.0[1]
1. Brazil	70.0	79.9	91.0	95.5	104.4	107.3
2. Mexico	57.1	77.9	85.8	93.7	97.3	99.0
3. Argentina	27.3	33.7	43.6	46.0	45.8	50.8
4. Venezuela	29.6	31.9	31.8	32.3	34.2	33.6
5. Chile	12.1	16.6	17.3	18.2	20.0	21.0
6. Peru	10.0	10.3	12.2	12.4	13.2	13.4
7. Colombia	6.9	8.7	10.3	11.4	12.3	11.3
8. Ecuador	5.6	7.3	7.6	8.1	8.3	8.5
9. Panama	3.0	3.3	3.8	4.3	4.3	N.A.
10. Costa Rica	2.7	3.3	3.5	4.3	4.1	4.2

*Estimated total external liabilities
N.A.: Not Available

[1] 1985 Latin American estimate obtained from Preliminary Overview of the Latin American Economy, Economic Commission for Latin America and the Caribbean, Table 15

Source: World Bank, World Debt Tables: External Debt of Developing Countries (1985 selected country figures on page xxv).

TABLE 2

LATIN AMERICA AND THE CARIBBEAN: TOTAL DEBT SERVICE*
ON LONG-TERM DEBT, 1980-1984
(billions of dollars)

Country	1980	1981	1982	1983	1984
Latin America and Caribbean	38.6	44.6	48.4	39.2	43.9
Brazil	13.1	15.3	16.8	10.5	10.8
Mexico	9.3	10.6	12.3	12.5	15.7
Argentina**	2.0	2.2	2.3	2.3	2.9
Venezuela**	3.0	2.6	3.2	2.7	2.5
Chile	2.4	3.2	3.2	2.3	2.6
Peru	1.8	2.2	1.9	1.1	1.0
Colombia	.6	.8	1.1	1.2	1.3
Ecuador**	.6	.9	1.1	.5	1.0
Panama	.5	.5	.6	.5	.5
Costa Rica	.3	.3	.3	.6	.4

*actual repayments of principal and interest made in foreign currencies, goods, or services in the year specified

**debt service datum available on public and publicly-guaranteed debt only

Source: World Bank, *World Debt Tables: External Debt of Developing Countries*, 1985-1986 Edition.

EFFECTS OF THE DEBT CRISIS

U.S. Agricultural Economy

The effect of the international debt crisis has been acutely felt by U.S. farmers. Developing countries have been a major growth area for U.S. agricultural exports--in 1980, U.S. agricultural exports to Latin America comprised 15 percent of total U.S. agricultural exports (See Tables 3 and 4). In 1981, Latin America was the third largest market for U.S. farm exports.[8] However, sharply rising interest rates and worldwide recession in the early 1980s hampered the developing nations' import and export capacity, resulting in a contraction in trade worldwide.

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[8] U.S., Department of Agriculture, Economic Research Service, *U.S. Foreign Agricultural Trade Statistical Report, Calendar Year 1981*, Table 13.

In the face of declining exports and commercial bank intransigence in making new loans, these debtor nations have been forced to reduce imports to generate necessary foreign exchange.

Since 1981, the value of U.S. agricultural exports to Latin America has, on the whole, declined. Table 4 illustrates this trend. Between 1981 and 1985, the value of U.S. agricultural exports to Latin America fell 32 percent. The percentage decline in the value of U.S. farm exports to certain Latin American debtors during this same period has been even more startling: exports to Argentina have fallen $23 million, or 61 percent, exports to Chile have declined $194 million--67 percent, and exports to Peru have fallen $303 million, or 80 percent.

While falling commodity prices have no doubt accounted for part of the decline in export value, the austere import policies adopted by Latin American debtors have contributed significantly to the declining quantity of U.S. agricultural exports since 1981. For example, the volume of wheat exported to Latin America has fallen from 7.1 million metric tons in 1981 to 5 million tons in 1985, nearly a 30 percent decrease. Volume exports of soybean oil to Latin America have also plummeted, from 269,000 metric tons in 1981 to 107,400 in 1985, a total decline of 60 percent.[9]

TABLE 3

TOTAL U.S. AGRICULTURAL EXPORTS, VALUE AND VOLUME
FISCAL YEARS 1980-1985

1980	1981	1982	1983	1984	1985
(billions of dollars)					
40.5	43.8	39.1	34.8	38.0	31.2
(million metric tons)					
163.9	162.6	157.9	144.8	143.6	125.7

Source: U.S. Department of Agriculture. Economic Research Service. World Agriculture, Various Issues and FATUS: Foreign Agriculture Trade of the United States (as cited in Patterns in Trade of Selected U.S. Agricultural Exports, by Donna U. Vogt and Barry Carr, Congressional Research Service, June 26, 1985, updated January 30, 1986).

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[9] U.S., Department of Agriculture, Foreign Agricultural Service.

TABLE 4

U.S. AGRICULTURAL EXPORTS TO LATIN AMERICA AND SELECTED COUNTRIES
(Millions of dollars)

Country	1980	1981	1982	1983	1984	1985
Latin America	5,999	6,210	4,438	5,211	5,263	4,224
Argentina	50	38	17	18	19	15
Brazil	680	710	526	479	508	470
Chile	314	288	246	206	155	94
Ecuador	119	122	105	115	151	101
Mexico	2,468	2,432	1,156	1,942	1,993	1,439
Peru	282	379	278	309	176	76
Venezuela	701	893	671	665	783	638

Sources: Foreign Agricultural Trade of the United States, Calendar Year 1985 Supplement, Table 11.
U.S. Foreign Agricultural Trade Statistical Report, Calendar Year 1983, Table 12.
U.S. Foreign Agricultural Trade Statistical Report, Calendar Year 1981, Table 13.

The U.S. soybean export picture is equally grim. Tables 5,6, and 7 illustrate the shrinking share of the world soybean and soybean product markets held by the United States. Brazil's soybean production has soared since 1982, rising from a six percent share to a 14 percent share of the world market between 1983 and 1985. Argentina, too, has dramatically increased its exports of soybeans from six percent of the world market in 1981/82 to 13 percent in 1984/85. Combined, these two debtor nations held 27 percent of the world market in 1984/85, up from a combined share of nine percent in 1981/82, while the U.S. share has fallen 21 percentage points to 65 percent in 1984/85. Between 1980 and 1985, Argentina almost gained the percentage of the world soybean meal export market the United States lost. The U.S. share dropped 13 percentage points during this period, while Argentina picked up 11 points. Argentina has also drastically increased its soybean oil world export market share--rising 11 percentage points between 1981 and 1985, while the share of the United States fell 7 percentage points.

TABLE 5

SOYBEAN EXPORTS BY VOLUME--WORLD, U.S., AND MAJOR U.S. COMPETITORS, AND PERCENTAGE OF MARKET SHARE, FISCAL YEARS 1978-85

	WORLD EXPORTS	U.S.		BRAZIL		ARGENTINA	
Year	MMT	MMT	% of World	MMT	% of World	MMT	% of World
1978/79	24.7	20.12	81	.64	3	2.79	11
1979/80	28.5	23.82	84	1.24	4	2.37	8
1980/81	25.3	19.71	78	1.80	7	2.70	11
1981/82	29.3	25.28	86	.86	3	1.88	6
1982/83	28.6	24.63	86	1.31	5	1.42	5
1983/84	26.2	20.21	77	1.59	6	2.97	11
1984/85	25.2	16.28	65	3.48	14	3.29	13
1985/86 (Prelim)	26.00	20.14	77	1.2	5	2.54	10

Source: U.S. Department of Agriculture. Foreign Agriculture Service. Foreign Agriculture Circular: Soybeans. April 1985; FOP 11-85, November 1985; FOP 12-86, December 1986 (as cited in Patterns in Trade of Selected U.S. Agricultural Exports, by Donna U. Vogt and Barry Carr, Congressional Research Service, June 26, 1985, updated January 30, 1986).

TABLE 6

VOLUME OF SOYBEAN MEAL EXPORTS--WORLD, U.S., AND MAJOR U.S. COMPETITORS, AND PERCENTAGE OF MARKET SHARE
October-September Marketing Years, 1978-1985

	WORLD EXPORTS	U.S.		BRAZIL		ARGENTINA	
Year	MMT	MMT	% of World	MMT	% of World	MMT	% of World
1978/79	15.48	6.00	39	5.45	35	.38	2
1979/80	17.34	7.20	41	5.44	31	.26	1
1980/81	18.83	6.15	33	7.74	41	.41	2
1981/82	20.74	6.27	30	8.35	40	.74	4
1982/83	23.29	6.45	28	8.24	35	1.55	7
1983/84	21.40	4.86	23	7.71	36	2.12	10
1984/85	22.29	4.46	20	8.44	38	2.88	13
1985/86 (Prelim)	22.55	5.45	24	7.38	33	3.2	14

Source: U.S. Department of Agriculture. Foreign Agriculture Service. Foreign Agriculture Circular: Oilseeds and Products, 1985; FOP-4-85, April 1985; FOP-6-84, June 1984 and FOP-27-80, December 1980; FOP 10-82, August 1982, and FOP 11-85, November 1985; FOP 12-86, December 1986 (As cited in Patterns in Trade of Selected U.S. Agricultural Exports, by Donna U. Vogt and Barry Carr, Congressional Research Service, June 26, 1985, updated January 30, 1986).

TABLE 7

VOLUME OF SOYBEAN OIL EXPORTS--WORLD, U.S., AND MAJOR U.S. COMPETITORS, AND PERCENTAGE OF MARKET SHARE
October-September Marketing Years, 1978-1985

	WORLD EXPORTS	U.S.		BRAZIL		ARGENTINA	
Year	MMT	MMT	% of World	MMT	% of World	MMT	% of World
1978/79	2.97	1.06	36	.56	19	.05	2
1979/80	3.27	1.22	37	.53	16	.11	3
1980/81	3.35	.74	22	1.15	34	.06	2
1981/82	3.51	.94	27	.85	24	.12	3
1982/83	3.81	.92	24	1.02	27	.27	7
1983/84	3.97	.83	21	.99	25	.43	11
1984/85	3.66	.75	20	.98	27	.50	14
1985/86 (Prelim)	3.16	.57	18	.45	14	.63	20

Source: U.S. Department of Agriculture. Foreign Agriculture Service: Foreign Agriculture Circular Oilseed and Products, FOP-4-85, April 1985; FOP-6-84, June 1984 and FOP-27-80, December 1980; FOP-10-82, August 1982, FOP 11-85, November 1985, FOP 12-86, December 1986 (as cited in *Patterns in Trade of Selected U.S. Agricultural Exports*, by Donna U. Vogt and Barry Carr, Congressional Research Service, June 26, 1985, updated January 30, 1986).

Besides reducing agricultural imports from the United States, the Latin American debtors have made concentrated efforts to step up exports. Since many of these nations' export sectors are agricultural, the U.S. farmer has faced increased foreign competition while coping with domestic recession. Table 8 illustrates the rise in the value of Latin American farm exports to the United States. The value of imports from Latin America has risen 16.7 percent between 1981 and 1985. Both Chile and Venezuela have achieved a growth rate of over 200 percent during this same period, while Ecuador and Peru have increased exports over 50 percent.

TABLE 8

AGRICULTURAL IMPORTS FROM LATIN AMERICA AND SELECTED COUNTRIES
(Millions of Dollars)

Country	1980	1981	1982	1983	1984	1985
Latin America	7,255	6,544	5,652	6,177	7,176	7,639
Argentina	305	469	252	281	314	308
Brazil	2,019	1,905	1,495	1,655	2,111	2,333
Chile	46	68	96	126	157	212
Ecuador	356	315	347	290	412	526
Mexico	1,059	1,102	1,158	1,279	1,279	1,446
Peru	151	102	136	130	167	160
Venezuela	18	11	11	16	33	37

Sources: Foreign Agricultural Trade of the United States, Calendar Year 1985 Supplement, Table 20.
U.S. Foreign Agricultural Trade Statistical Report, Calendar Year 1983, Table 17.
U.S. Foreign Agricultural Trade Statistical Report, Calendar Year 1981, Table 22.

The recent Joint Economic Committee study also attributes, at least partly, the failure of many agricultural banks to the repercussions of the Latin debt crisis on the U.S. farm economy. While the correlation probably can not be drawn directly, the general effects of the contraction in U.S. farm exports to Latin American have no doubt contributed to the general problems in the farm economy and farm financial institutions.[10]

Debtor Nation Economies

Latin American leaders have claimed, not untruthfully, that the brunt of the adjustment burden to the world economy of the 1980s has fallen on their nations. The debt crisis, precipitated by industrial countries' disinflationary policies and commercial creditors' refusal to roll over outstanding loans, has been felt by all people in the affected nations. Popular unrest has forced many Latin American leaders to search for different solutions to current policies. Peruvian President Alan Garcia's announcement in 1985 that Peru would limit its interest payments to 10 percent of export earnings is only one example of the growing militancy with which debtor nation leaders are facing debt service requirements.

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[10] Joint Economic Committee, "The Impact of the Latin American Debt Crisis on the U.S. Economy," p. 14.

The debtor nations have, foremost, suffered declining standards of living: among other economic indicators--falling GDP growth rates and terms of trade, and rising unemployment and inflation rates. Latin America's GDP growth rate fell from 5.3 percent in 1980 to a negative 2.5 percent in 1983. Between 1980 and 1985, the average Latin American GDP growth rate was 1.3 percent.[11] Argentina's unemployment rate has soared since 1980--up 4 percentage points to 6.6 percent in 1985. Between 1981 and 1982, Chile's unemployment rate rose 11 percentage points to a staggering 20 percent and has remained near that percentage ever since.[12] Latin America's notorious inflation rates have run rampantly since 1981. The average rate of price increases in the region's economies rose from 57.6 percent in 1981 to 328.3 percent in 1985. Argentina, Peru, and Brazil posted inflation rates well over 150 percent in 1985.[13] Finally, since 1981, Latin America's terms of trade (purchasing power of export revenues in world markets) have been negative, with the exception of 1984.[14]

The domestic miseries of Latin American debtors have stemmed from policies of squeezing domestic consumption to develop export industries. A leading Brazilian agronomist recently reported that per capita production of such domestically consumed products as rice, black beans, manioc, and potatoes fell 13 percent from 1977 to 1984, while per capita production of agricultural exports such as soybeans, oranges, cotton, and peanuts rose 15 percent.[15]

A phenomenon only recently gaining attention is capital flight from debtor nations. The unsteady economies of Latin America have eroded domestic business confidence and spurred the flight of huge amounts of money--mostly to the United States. An oft-cited study by Morgan Guaranty Trust Company estimates that Mexicans have deposited $53 billion in the United States in the last decade and $17 billion since 1983--more than enough to cover the $5.6 billion growth in Mexico's external debt since 1983. In all, Third World countries have lost $200 billion to safer financial markets in the last decade, according to the same study.[16] James Henry, a New York economist and writer, estimates the U.S. share of private flight capital from Mexico and Venezuela to be 70 to 80 percent, and 50 to

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[11] Preliminary Overview of the Latin American Economy 1985, Table 1.

[12] Ibid., Table 4.

[13] Ibid., Table 5.

[14] Ibid., Table 9.

[15] Washington Post, 26 October 1986, sec. D, p. 4.

[16] Journal of Commerce, 24 October 1986, 12A.

60 percent for Brazil and Argentina.[17] The United States may very well be a net debtor to these Latin American nations.

Commercial Banks

The stability of the international banking system was a legitimate concern during the 1982 debt crisis. A default could have eliminated a good portion of the equity capital of several major U.S. banks and deepened the worldwide recession already in progress. Furthermore, commercial bank exposure was concentrated in the four highest-debt nations, Brazil, Mexico, Argentina, and Venezuela, and a handful of major banks. The nine money center banks' exposure in Mexico, Brazil, Argentina, and Venezuela in 1984 amounted to 124.4 percent of their total capital. As time has passed, however, the risk of a country default has been virtually eliminated and the international banking system has remained stalwart.

Since 1982, several developments in international banking have strengthened the system. First, commercial banks have slowed lending to Latin debtors, despite the fact that modest commercial bank lending was a part of the original debt strategy formulated in 1982. Between 1981 and 1985, commercial bank lending to Latin America increased only $1.8 billion, or 3.5 percent[18]. During this same period, the external debt of most Latin American debtors was rising at a much higher rate, while export revenues were falling.[19]

The continued hesitance on the part of commercial banks to continue and increase lending activity to Latin American debtors has, in the most immediate sense, precipitated the forced adjustments in economic policies undertaken by the debtor nations. Latin American nations borrowed on the premise that they would not be able to pay back loan principal when it came due. Rather, the banks would renew the loans. What was important was keeping current on interest payments. In 1982, the various external factors that contributed to the debtors' debt servicing difficulties eroded confidence to the point where the major creditor banks refused to roll over these nations' foreign debts.[20]

Second, commercial banks involved in Latin America have increased capital (subordinated debentures, loan loss reserves, and equity), especially loan loss reserves, to comply with a 1983 Federal Reserve guideline mandating that the 17 largest banks hold capital equal to at least 5 percent of their assets.[21] As a result, total commercial bank exposure in Latin America, defined as claims adjusted to reflect the risk to the involved banks, has declined from 119 percent of capital in 1982 to 87 percent of capital by the end of the first half of 1985.[22] Between 1984 and 1985 alone, the nine money center banks' exposure as a percentage of total capital in Brazil declined 7.7 percentage points, in Argentina, 1.4 percentage points, and in Venezuela, 3.9 percentage points (Table 9).

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[17] James S. Henry, "Where the Money Went," The New Republic, 14 April 1986, pp. 20-23.

[18] Joint Economic Study, p. 18.

[19] Preliminary Overview of the Latin American Economy 1985, Tables 7 and 15.

[20] Watkins, Till Debt Do Us Part, pp. 73-74.

Finally, since 1983 a secondary market for LDC loans has existed, enabling banks to sell or swap debtor nations' loans with each other.[23] These loans are sold at a discount, which reflects the market value of the debt. The debt purchase may be part of a debt-for-equity swap, to be discussed later, or may be made to diversify the bank's international loan portfolio. Such diversification adjusts a bank's exposure in various nations.

As a result of these developments, the major U.S. commercial banks holding Latin American loans have not only survived the 1982 crisis, but have also reported healthy profits since that time. In light of these profits, it is little wonder that the Latin American debtors are resentful of the pain imposed on their citizens by austere, IMF-monitored economic policies. Between 1982 and 1985, profits at the nine major commercial banks holding Latin American loans rose 21.5 percent. Morgan Guaranty alone posted a 79 percent profit rate growth over this period (See Table 10).

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[21] Arlene Wilson, The Stability of the International Banking System (Washington, D.C.: Congressional Research Service, Library of Congress, D.C., updated 10 October 1986), p. 9.

[22] U.S., Department of State, Report to Congress on Foreign Debt in Latin America, prepared by the Department of State, December 1985, p. 10.

[23] Walter W. Eubanks, LDC Debt Developments and Regulatory Implications for U.S. Banks (Washington, D.C.: Congressional Research Service, Library of Congress, updated 10 October 1986), pp. 7-8.

TABLE 9

MONEY CENTER BANKS' EXPOSURE TO 5 LARGEST LATIN BORROWERS*
(millions)

	Nine Banks' Exposure as of 30 Sept. '84 as a percentage of		Nine Banks' Exposure of 30 Sept. '85 as a percentage of	
Country	Total Capital**	Exposure of all U.S. banks	Total Capital	Exposure of all U.S. banks
Brazil	44.9%	65.2%	37.2%	67.7%
Mexico	42.4	54.9	34.9	56.3
Venezuela	21.7	67.9	17.8	70.9
Argentina	15.4	64.0	14.0	69.3
Chile	11.2	57.0	9.3	61.0

*nine money center banks are BankAmerica, Citibank, Chemical, Chase Manhattan, Morgan Guaranty Trust, Manufacturers Hanover, Continental Illinois, Bankers Trust, and First National Bank of Chicago

**total capital for all nine includes equity, subordinated debentures and provisions for loan losses; as of June 30, 1983, it totaled $30.2 billion

Source: Federal Financial Institutions Examination Council (as cited in LDC Debt Developments and Regulatory Implications for U.S. Banks, Walter W. Eubanks, Congressional Research Service, Washington, D.C.)

TABLE 10

NET INCOME AT NINE MONEY CENTER BANKS, 1982-1985
(Millions of dollars)

Money Center Bank	1982	1983	1984	1985
Bankers Trust	$ 223	$ 257	$ 307	$ 371
Bank of America	395	390	346	-337
Chase Manhattan	307	430	406	565
Chemical	241	306	341	390
Citicorp	723	860	890	998
Continental Illinois	84	101	-1,088	134
First Chicago	137	184	86	169
Manufacturers Hanover	295	337	353	407
Morgan Guaranty	394	460	538	705
TOTAL	$2,799	$3,325	$2,179	$3,402

Source: Salomon Brothers, Inc., A Review of Bank Performance: 1986 Edition. For Continental Illinois, "Annual Scoreboard of 200 Banks," Business Week, various issues (as cited in Joint Economic Committee report, "The Impact of the Latin American Debt Crisis on the U.S. Economy").

POLICY OPTIONS

Current and alternative policies regarding the international debt situation must be analyzed in the context of an overall set of goals for both debtor and creditor nations. Alfred Watkins defines the most important objectives that should be met by U.S. policy toward debt-laden Latin American nations: 1) stability of the international financial system; 2) economic and political stability in Latin America; 3) economic growth in the United States; and, 4) an open world economy.[24]

Current Policy Environment

The attention given to the the international banks in current policies has ensured a healthy international financial system, as the prior section attests. But to what extent have other policy objectives been sacrificed?

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[24] Watkins, Till Debt Do Us Part, pp. 62-64.

Political and economic stability in Latin America is a crucial U.S. objective for several reasons. Most important for the U.S. farm sector, Latin America remains an important export market with untapped potential. Such key national security concerns as drug eradication and interdiction and the maintenance (or installation) of Western-oriented, democratic regimes also requires U.S.-Latin American dialogue and cooperation in debt-related issues. Economic health is a necessary prerequisite for stable democracies, and the region's history of military dictatorships and human rights abuses has only just begun to change, with military governments swept out of office in ten Latin American nations since 1979.[25]

The contribution of the current policy environment to Latin America's economic and political stability is questionable. The hardship suffered by Latin American debtors has already been discussed. Recent riots in Brazil to protest sharp price increases, and Brazilian party leaders' calls for a unilateral moratorium on foreign debt payments are only the most recent example of the volatile political nature of the debt issue in Latin America. Brazil, a nation enjoying the highest economic growth in the world in 1985 and touted in recent years' as a model debtor nation, is now suffering declining foreign exchange reserves and a deteriorating trade position.[26] The policy environment dictated by the United States in 1982 has forced destabilizing economic decisions upon Latin American leaders--has forced Latin American leaders to choose, as aptly stated by Peruvian President Garcia in a September 1985 speech, between "debt and democracy." It has instigated, in some cases, anti-U.S. sentiment within debtor nation governments and citizens. The political wisdom of such policies is an important consideration in the international debt debate.

The current policy environment toward Latin America has promoted neither U.S. economic growth nor an open trading system, Watkins' third and fourth goals. The damage to the U.S. agricultural sector has been well documented; the U.S. manufacturing sector has been significantly injured as well. Furthermore, the traditional IMF austerity programs may only aggravate the situation over the long run, producing a spiral of declining GNPs and reduced world trade. Should falling Latin American demand for U.S. exports reduce total U.S. domestic demand or generate protectionist legislation, U.S. imports, including those from Latin America, would fall, and the debtor nations would be forced to implement even more stringent economic programs to maintain foreign debt interest payments. While U.S. aggregate demand has, in fact, been growing in recent years, the considerable damage to U.S. agriculture and manufacturing may increase the already great pressure on Congress to pass a protectionist law in 1987.

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[25] Washington Post, 12 November 1986, Section A, p. 24.

[26] Journal of Commerce, 2 December 1986.

Macroeconomic Policy Environments

Developed Nations. Adoption of a U.S. macroeconomic environment conducive to growth and trade in both the United States and debtor nations is the ideal. Specifically, reduction of the twin U.S. deficits, budget and trade, would ease protectionist pressure and stem the capital inflows necessary to finance excessive government spending. The newly elected Democratic-led Congress has pledged that trade policy will be at the head of its legislative agenda. Reduction of the trade deficit is no doubt desirable; however, protectionist legislation will only lead to reduced economic welfare worldwide. Appropriate fiscal and monetary policies that reduce both deficits are far wiser.

While it is beyond the scope of this paper to analyze the U.S. macroenvironment, U.S. policy makers are aware of the need to formulate macroeconomic policy in the context of the international economy. A convincing case can be made that the unexpected, severe disinflationary policies adopted by the United States between 1979 and 1982 instigated not only the international debt crisis, but also the huge trade deficits that still plague our economy. The extreme decline in capital outflows between 1982 and 1985 occurred, in large part, because U.S. banks reduced lending to debtor nations, and accounts for the emergence of a positive U.S. capital account and its mirror image, a negative current account.[27] Furthermore, the disinflation and ensuing worldwide recession are also largely responsible for the U.S. budget deficit.

Appropriate macroeconomic policy environments in other industrialized nations are as necessary for a healthy international economy as the macroeconomic policy environment of the United States. Integrated worldwide financial markets and the volume of world trade have internationalized macroeconomic policies the repercussions of which were once thought to be purely domestic. Treasury Secretary James Baker's May 1986 Tokyo proposal to coordinate the macroeconomic policies of major industrialized nations has its merits, but its success so far has been negligible. Baker's efforts to persuade West German and Japanese leaders to expand their nations' economies have met stiff resistance. Nonetheless, coordinated policies that promote international economic growth can only benefit Latin American debtors.

Debtor Nations. The macroeconomic policies of developing debtor nations have long been a notorious impediment to economic growth. Heavy tariffs, misaligned exchange rates, excessive military expenditures, and misallocated government investment priorities are not unusual for most developing nations. A shift in focus from exports and foreign exchange earnings to policies promoting internal growth and stability and satisfying domestic demand would ease not just domestic pressures on Latin American leaders, but also pressures from developed nations that have found their Latin American imports so dramatically reduced in recent years. These debtor nations, most of which are still developing, cannot make difficult economic adjustments alone. Multilateral development institutions have played and will continue to play an important role in the macroeconomic and trade policy environments structured by Latin American and other developing nation leaders.

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[27] Paul Craig Roberts, "Beneath the 'Twin Towers of Debt'," *Wall Street Journal*, 28 October 1986.

The World Bank's emerging role in assisting debtor nations restructure their macroeconomic and trade regimes is a natural evolution in the general view of the debt crisis, which can no longer be treated as a "short-term, liquidity crunch."[28] Clearly, long-term, individually-crafted stabilization programs are one part of the solution to the international debt situation.

World Bank development financing has been a source of controversy in recent months. The issue of development assistance to debtor nations for the purpose of expanding exports that compete with those of the United States and other creditor nations is sensitive to many organizations. Latin American soybean expansion is a case in point. Distinction between short-term and long-term may be helpful at this juncture. Development assistance to support what Senator Bill Bradley terms "panic-exporting"[29] by Latin American debtors only serves to squeeze Latin economies and injure competing export sectors in other nations. Long-term assistance to restructure debtor nation economies and maintain foreign exchange earnings can and must be made without sacrificing domestic consumption and materially injuring the economies of creditor nations. The World Bank is in an excellent position to redefine its role--but it must do so with all involved parties in mind.

Macroeconomic changes are a necessary foundation for the specific policies which must directly address the debt issue.

Specific Policy Options

Secretary Baker's 1985 Seoul announcement of a new Administration approach to the international debt situation legitimized the growing consensus that creditor nations must look at the international debt situation in a fresh, new light. The Baker proposal has instigated a storm of controversy, and several counterproposals have been offered under such auspices as debt relief, debt-for-equity, and debt-trade linkages. Congressional action on the debt situation may be included in omnibus trade legislation drafted in 1987.[30] Regardless, formulation of U.S. policy, whether by Congressional mandate or executive action, must include all industries affected by the Latin debt situation to enjoy any degree of success and acceptance.

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[28] "A Change of Pace," World Bank Survey, Economist, 27 September 1986, p. 9.

[29] Journal of Commerce, 21 November 1986, section A, p. 14.

[30] Wall Street Journal, 25 November 1986, p. 60.

Baker Plan. Secretary Baker's "Program for Sustained Growth" calls for commercial bank and multilateral development institution financing of $29 billion over three years, as well as an increased role for the World Bank through policy-based lending. Debtor nations[31] must, in turn, adopt comprehensive macroeconomic and structural market-oriented reform policies. In 1986 testimony before the Senate Finance and Banking Committees, Secretary Baker emphasized, among other things, increased savings and investment, improved economic efficiency through deregulation and privatization, and a rationalization and liberalization of debtors' trade regimes. He stated, "Once debtor nations have designed economic reform programs to improve their growth prospects that have [International Monetary] Fund and [World] Bank support, it will be critical for the commercial banks to fulfill their pledges of financial support for these programs."[32]

Baker's plan, like the 1982 Mexican debt rescue, is premised on the assumption that the Latin debt situation is a short-term liquidity crunch. In 1982 and in subsequent years, the IMF took the lead in monitoring short-term stabilization programs and negotiating rescue packages for acquiescent debtor nations. This role was compatible with its established international function of lending to nations with short-term balance-of-payments deficits and assumed that debtor nations would soon recover and regain debt-servicing capabilities. Baker's proposal to provide "bridge" loans to debt-squeezed nations also assumes that in a reasonable time frame the debtor nations will be able to assume servicing their debt without new loans.

The important questions to ask with respect to the Baker plan are: 1) if the plan would provide enough money to the debtors to allow them to pay interest and avoid further austerity, and; 2) if, by increasing the foreign debt on these nations, the Baker plan is ignoring long-term structural imbalances between debtors' trade balances and debt-service requirements. I.e., will more debt help nations who already suffer from too much debt?

An analysis of certain standard solvency indicators (which measure long-term ability to repay debt) can give a rough estimation of the debtor nations' long-term financial positions. The ratio of total debt service to export earnings (Table 11) for Latin

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[31] The Baker plan would apply to a group of 15 potential participating nations. These nations include Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Ivory Coast, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, and Yugoslavia.

[32] Statement by the Honorable James A. Baker, III, before the International Trade Subcommittee of the Senate Finance Committee and the International Finance and Monetary Policy Subcommittee of the Senate Banking Committee, 13 May 1986.

America and the Caribbean example has generally risen since 1980. A ratio of 30 percent or more is considered high.[33] Most countries were above or near this percentage, with the exceptions of Venezuela, Chile, and Peru. Peru, it must be noted, has voluntarily limited its debt service to a given percentage of export earnings. Most countries' debt service/export earnings ratio has risen since 1981--some more than others. Argentina's ratio has risen 10.9 percentage points, Mexico's, 6.4 percentage points, and Colombia's, 7.2 percentage points.

A second commonly cited long-term solvency measure is the ratio of gross external liabilities to export earnings (Table 12). In 1980, this ratio for all of Latin America was 190.5 percent; by 1983 it had reached 299.7 percent. The 1984 ratio for each of the 10 selected debtor nations is significantly higher than that of 1981; however, for most nations the ratio has fallen between 1983 and 1984 because of increased export earnings.

Finally, one of the most telling indicators for Latin America is in Table 13, which charts the ratio of gross external liabilities to gross national product (GNP). For all of Latin America and the Caribbean, gross external liabilities reached 60.5 percent of GNP. The 1984 ratios of Chile, Panama, and Costa Rica exceeded 100 percent of their GNPs, while those of the top four debtor nations, Brazil, Mexico, Argentina, and Venezuela, were over 50 percent of their GNPs. More importantly, Latin America's total debt/GNP ratio has risen every year since 1980, as have those of Brazil and Venezuela. The ratios of Argentina and Mexico declined in 1984, but remain significantly above their 1980 levels.

These three solvency measures illustrate the deteriorating long-term debt-servicing capacity of the Latin debtors and the flaws of the Baker proposal. The macroeconomic problems caused by IMF austerity programs plus the telling story of such ratios as cited above throw the fundamental assumptions of the Baker plan into question. The debt-servicing difficulties of Latin American nations reflect long-term, structural imbalances that the Baker plan does not address.

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[33] Patricia A. Wertman, Current Debt Servicing Capacity of the "Baker Plan" Fifteen (Washington, D.C: Congressional Research Service, Library of Congress, 31 March 1986, updated 5 May 1986), p. 9.

TABLE 11

RATIO OF TOTAL DEBT SERVICE TO EXPORTS OF GOODS AND SERVICES*
LATIN AMERICA AND CARIBBEAN, PLUS HIGHEST-DEBT NATIONS
1980-1985 (Percentages)

Country	1980	1981	1982	1983	1984
Latin America and Caribbean	21.3	21.5	26.0	24.4	N.A.
Brazil	34.5	33.6	43.0	27.9	26.6
Mexico	31.9	27.9	33.9	38.3	34.3
Argentina	17.7	18.2	23.6	23.5	29.1
Venezuela	13.3	10.6	16.0	15.3	13.4
Chile	21.9	29.6	20.0	18.5	26.2
Peru	30.9	44.9	36.4	19.7	15.3
Colombia	9.0	13.4	17.7	22.4	20.6
Ecuador	18.8	30.7	40.5	19.7	33.4
Panama	6.0	5.0	6.5	6.8	7.5
Costa Rica	16.8	16.4	12.0	50.3	25.8

*debt service on public and publicly guaranteed debt only
Source: World Bank, World Debt Tables: External Debt of Developing Countries, 1985-86 Edition.

TABLE 12

RATIO OF GROSS EXTERNAL LIABILITIES TO
EXPORTS OF GOODS AND SERVICES
LATIN AMERICA AND CARIBBEAN, PLUS TEN HIGHEST-DEBT NATIONS
1980-1984 (percentages)

Country	1980	1981	1982	1983	1984
Latin America and Caribbean	190.5	210.7	267.5	299.7	N.A.
Brazil	300.7	296.2	387.6	392.0	345.0
Mexico	231.9	256.2	309.6	327.3	301.1
Argentina	243.8	285.3	448.7	471.3	464.0
Venezuela	133.1	130.2	158.2	186.0	181.5
Chile	193.1	296.2	336.6	379.0	414.6
Peru	205.9	243.3	292.0	322.9	330.9
Colombia	118.3	173.7	207.1	278.4	231.0
Ecuador	189.4	243.9	277.3	302.3	280.2
Panama	38.4	33.4	40.6	61.5	62.1
Costa Rica	225.1	272.3	303.2	364.7	330.3

Source: World Bank, World Debt Tables: External Debt of Developing Countries, 1985-86 Edition (The World Bank: Washington, D.C., March, 1986).

TABLE 13

RATIO OF GROSS EXTERNAL LIABILITIES TO
GROSS NATIONAL PRODUCT
LATIN AMERICA AND CARIBBEAN, PLUS TEN HIGHEST-DEBT NATIONS
1980-1984, (Percentages)

Country	1980	1981	1982	1983	1984
Latin America and Caribbean	35.2	37.6	47.3	58.8	60.5
Brazil	28.9	30.2	33.9	48.6	52.7
Mexico	31.7	33.9	55.4	70.4	58.8
Argentina	48.8	61.2	79.9	69.2	64.7
Venezuela	50.2	48.4	48.0	49.4	76.0
Chile	45.5	52.6	78.6	101.9	115.0
Peru	53.8	47.9	58.5	75.3	79.5
Colombia	20.9	24.3	27.2	30.6	35.0
Ecuador	50.3	55.3	65.6	82.1	94.9
Panama	89.1	90.6	96.0	104.1	101.4
Costa Rica	59.7	141.1	154.4	156.5	134.0

*debt service on public and publicly guaranteed debt only
Source: World Bank, World Debt Tables: External Debt of Developing Countries, 1985-86 Edition (The World Bank: Washington, D.C., March, 1986).

Practical problems have also arisen with implementation of the Baker proposal. The reluctance of the commercial banks to renew and make new loans is well documented. Furthermore, Congress has sharply reduced fiscal year (FY) 1987 appropriations for many multilateral financial institutions. World Bank FY 1987 funding was cut 47 percent, the International Development Association, 7 percent, and[34] the Inter-American Development Bank, 55 percent, to name a few.

Interest Capitalization.[35] According to this scheme, proposed in 1984 by Federal Reserve Chairman Paul Volcker and Anthony Solomon, then President of the New York Federal Reserve Bank, commercial banks would capitalize additional debtor nation interest when interest rates reached a trigger level. Beyond this level, nations would not be expected to immediately pay the additional interest, and the banks would lend this amount to the debtor nation. The capitalized interest would not be not forgiven, just postponed. Such a plan, like the Baker proposal, would add more debt to these nations' load.

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[34] "Congress Cuts Deeply into Development Bank Funding," Bretton Woods Committee Review, Vol. 2, Number 3, Fall 1986, p. 3.

[35] Watkins, Till Debt Do Us Part, pp. 68-69.

This scheme, however, has several positive characteristics worth mentioning. First, a ceiling on interest payments would afford a benchmark for the financial planners of these debtor nations. Second, interest capitalization would not force harsher austerity measures on the nations when interest rates rose--measures which injure creditor exporting nations as much as the debtor nations. Finally, the burden of adjustment to rising debt-service payments would be distributed among all affected parties. The Latin debtors must eventually adjust their economies to pay for the increased interest; however, this adjustment could be made at a more politically acceptable pace than in the past. Trade partners of Latin America would also bear part of the burden when adjustment measures were made, again, at a more reasonable level. The banks' share of the burden would depend on how the capitalization was treated by law. For example, if capitalized interest was not counted as profits on earnings reports, reported profits would decline.

Bradley Plan. Senator Bill Bradley of New Jersey has proposed to deal with the international debt crisis through debt forgiveness. His plan has brought the concept of debt relief to the forefront of debate about solutions to the debt crisis. Senator Bradley has outlined a three-point, three-year trade-debt relief package for eligible debtor nations. This package would consist of:

-- 3 points of interest rate relief for one year on all outstanding commercial and bilateral loans to eligible countries;
-- 3% write-down and forgiveness of principal on all outstanding commercial and bilateral loans to eligible countries; and
-- 3 billion dollars of new multilateral project and structural adjustment loans for eligible countries[36]

In turn, Bradley does not advocate conditionality. Rather, he suggests a set of economic policy guidelines for debtor nations to construct their own economic reform programs.

Bradley's plan has been both hailed and roundly denounced. Proponents naturally include Latin America, the largest ten nations of which would gain $42 billion of debt relief from commercial banks, according to Bradley. U.S. agriculture and other affected U.S. export industries would benefit from a loosening of Latin austerity policies. The sticking point would be the banks, which would probably oppose such drastic steps. Such considerations as share prices and reported profits would mean hard-hitting opposition to a plan such as Bradley's, especially if the Latin

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[36] The Honorable Bill Bradley, A Proposal for Third World Debt Management, Zurich, Switzerland, 29 June 1986, p. 4.

American debtors were not explicitly required to "bear part of the burden" as well.

Debt-For-Equity. Debt-for-equity swaps involve the purchase of a portion of a nation's debt on the secondary international loan market by a multinational corporation, which subsequently swaps the debt for equity investment in that nation. Since November of 1985, Chile has regularly held auctions to take bids from parties that desire to unload government loans for cash. Participants have to agree to invest the cash domestically.[37] Mexico has also actively swapped debt for equity--$1 billion in 1986 and more slated for 1987.[38] Auto companies have so far been the main corporate players in the Mexican swaps; Volkswagen in December, 1985, purchased US$283 million in Mexican debt for US$170 million and swapped it with the Mexican government for US$260 million in pesos.[39] Debt-for-equity swaps have so far retired an insignificant amount of debt. Morgan Guaranty Trust Company reports that only $3 billion of the foreign debts of Chile, Brazil, Mexico, Argentina and the Philippines has been retired through such swaps, compared to their $220 billion owed to foreign commercial banks.[40]

The positive features of such swaps are significant. Foremost, the debtor nations reduce their debt. The multinational investment may create a more favorable domestic investment climate in the debtor nation and encourage the return of flight capital. Multinational corporations may make investments they would not normally have made in light of the bargain such swaps offer. International bankers cut their losses on old foreign loans. Although developing nations have traditionally opposed foreign investment, the gravity of many developing nations' debt situations may make these swaps much more attractive in the future.

Truth-In-Banking.[41] Steve Hanke of Johns Hopkins University suggests a more radical step to complement debt-for-equity swaps: "truth-in-banking". He contends that debt-for-equity swaps are little used because banks are unwilling to take the loss involved with selling a Latin loan at a discount. If banks were required to "mark to the market" their Latin loans, that is, write down the loans to their discounted value in the secondary international loan market, the disincentive to sell such loans in the secondary market would be removed. Bankers, of course, would protest vehemently, but Hanke doubts that the international banking system would crumble. In fact, he believes the banking structure would be stronger if assets were correctly valued on banks' balance sheets. And, in light of the major commercial banks' reported profit rise since 1982, it seems possible that Hanke could be correct.

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[37] *Wall Street Journal*, 24 May 1986.

[38] *Journal of Commerce*, 16 December 1986, p. 3A.

[39] Ibid.

[40] *Wall Street Journal*, 27 October 1986.

[41] Steve H. Hanke, "Forcing Banks to Mark Down Loans," *New York Times*, 5 October 1986.

Special Debt Facility.[42] The past and present chairmen of the Congressional Joint Economic Committee, Representative David Obey of Wisconsin and Senator Paul Sarbanes of Maryland respectively, have suggested establishing a "special facility" as part of the IMF or World Bank. This facility would purchase Third World loans at a discount and restructure them at lower rates of interest and longer term maturity dates. They cite the special "oil facility" established by the IMF in the 1970s as a model. Financing of the facility would come from developed, wealthy nations with capital available for recycling to promote world growth.

This proposal has merits for the Latin debtors, but it would no doubt face opposition from both bankers and "capital-rich" countries. The already-mentioned reduction in FY 1987 appropriations for multilateral development institutions throws up an immediate stumbling block for such a facility. Bankers' unwillingness to discount foreign loans creates the same problems for the "special facility" as for debt-for-equity swaps.

CONCLUSION

There is little question that for U.S. agriculture the solution to the Latin American debt situation does not lie in more loans to the debtor nations. As long as major Latin American nations continue to bear heavy debt loads, they will be forced to implement austerity programs that expand exports and curtail imports. The Administration's proposal set out by Secretary Baker will only exacerbate the problems of the U.S. farm economy by stimulating Latin agricultural production and exports. The new democracies in Latin America will stagger under burdensome debt service while attempting to provide goods and services demanded by their citizens. American farmers will continue to see their foreign markets erode as Latin American nations dump their agricultural products in third-country markets while simultaneously closing their doors to U.S. exports. In the meantime, U.S. and foreign banks will continue to reap record profits from fundamentally bad loans.

From the standpoint of American agriculture, the best solution to the international debt crisis is one which conditions a systematic write-down of Latin American debt upon the designated countries' adoption of specific policies. These policies include eliminating import barriers and export subsidies, and diverting a greater share of domestic production of food and fiber for internal consumption. American banks should be encouraged to carry their outstanding loans to Latin American nations at market values and reduce the interest rates on those loans. No longer should major U.S. banks be able to report record profits on bad loans while U.S. farmers, exporters, and taxpayers bear the burden of Latin American trade surpluses generated for debt service requirements. Certainly any government-backed writeoff of Latin American debt would be a cost to the U.S. taxpayer. However, the increased economic activity that would result from reduced foreign competition and greater exports to debtor nations must be weighed against government costs.

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[42] David R. Obey and Paul S. Sarbanes, "Recycling Surpluses to the Third World," New York Times, 9 November 1986.

Discussion of the debt crisis should be an integral part of the Uruguay GATT Round. For all practical purposes, the United States has little in terms of trade restrictions to give up in the Uruguay Round to achieve trade concessions from such nations as Argentina, Brazil, and Mexico. However, the United States may be able to win such concessions by including the possibility of debt reduction in the trade negotiations.

In particular, economically powerful nations with large trade surpluses vis-a-vis the United States should be encouraged to make major commitments to a resolution of the debt crisis. Though they are certain to resist, it is ultimately in their interest to cooperate with the United States in providing debt relief, because the alternative may be a protectionist U.S. trade policy. Japan, specifically, could ease some of the current trade tensions with this country by cooperating in Third World debt restructuring. Other examples in both Europe and Asia will come to mind. The fundamental point is that, like trade barriers, the debt crisis is a multilateral problem to which unilateral solutions are unlikely to succeed.

The decision on how to approach the Latin American debt crisis is now in the hands of the U.S. Congress and the Administration. Pressure is building for a change. U.S. farmers and other exporters to Latin America are dissatisfied; Latin Americans are dissatisfied. The problem will not only not go away, but will become more acute with time. Furthermore, the Latin debt crisis is fundamentally intertwined with several other pressing issues--rising world protectionism, the huge U.S. trade deficit, and the U.S. farm crisis. Until the Latin debt situation is brought under control, these other problems cannot be successfully addressed. The U.S. government can no longer avoid the Latin debt problem. It must act--now.

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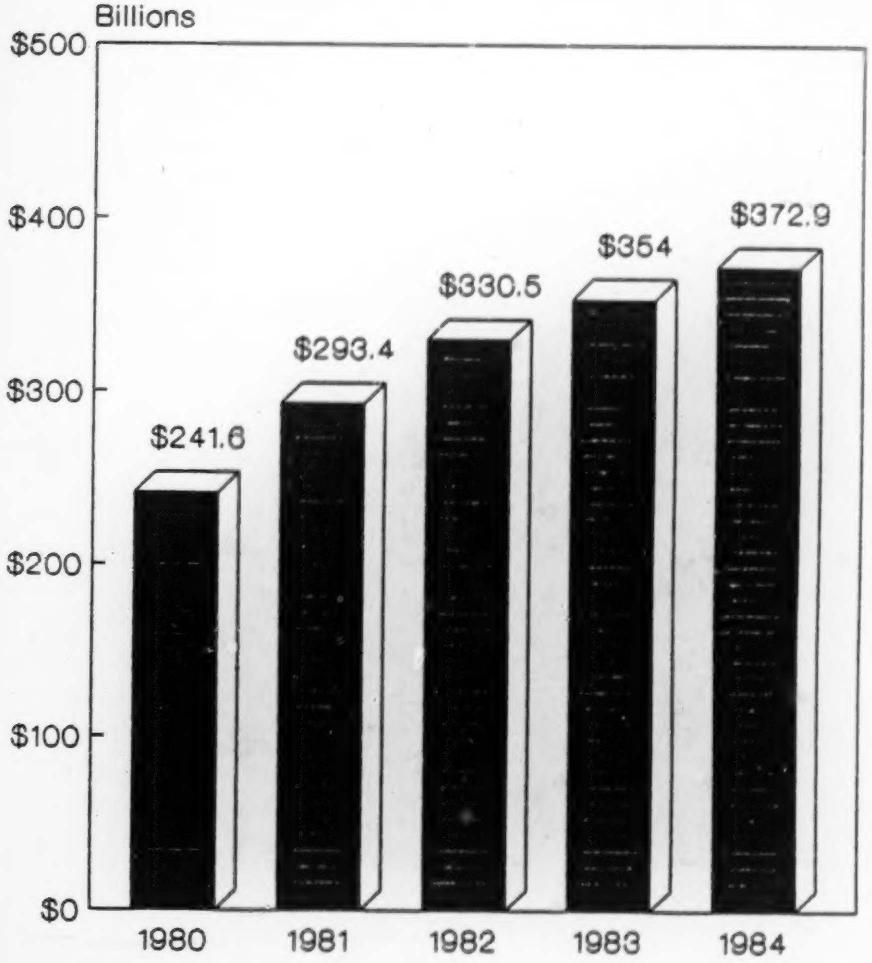
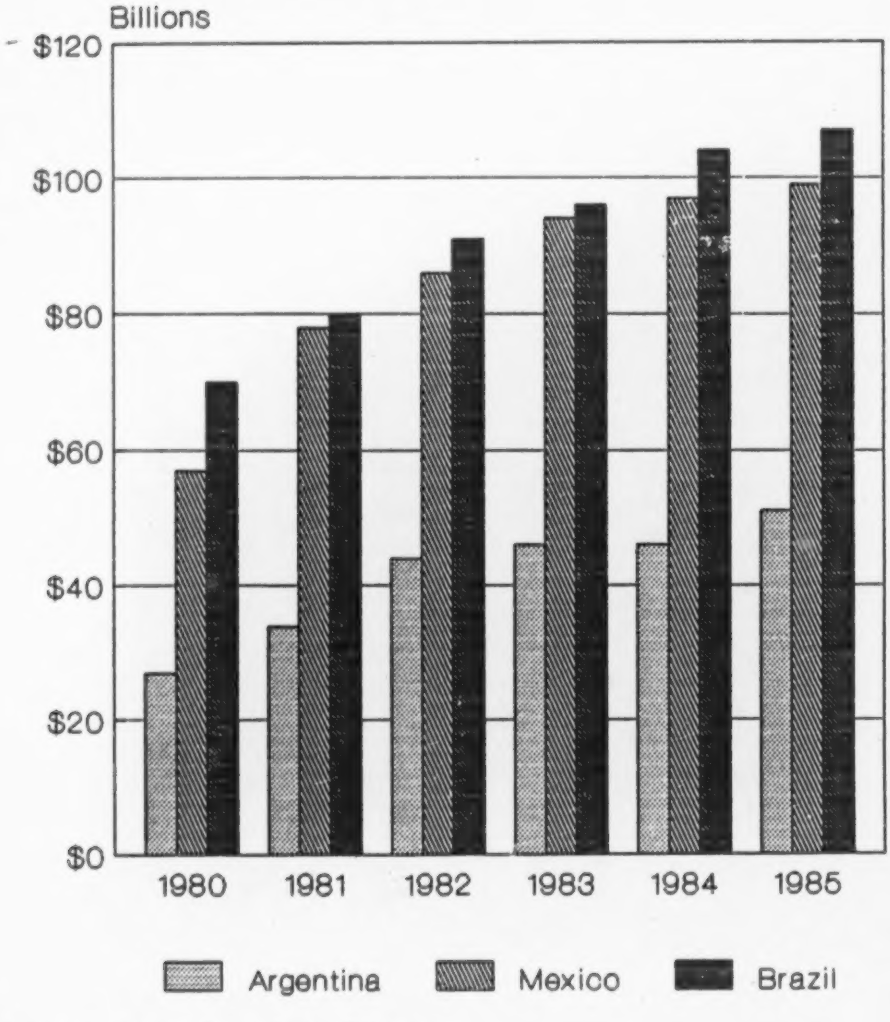
LATIN AMERICA AND THE CARIBBEAN GROSS EXTERNAL LIABILITIES, 1980-1984



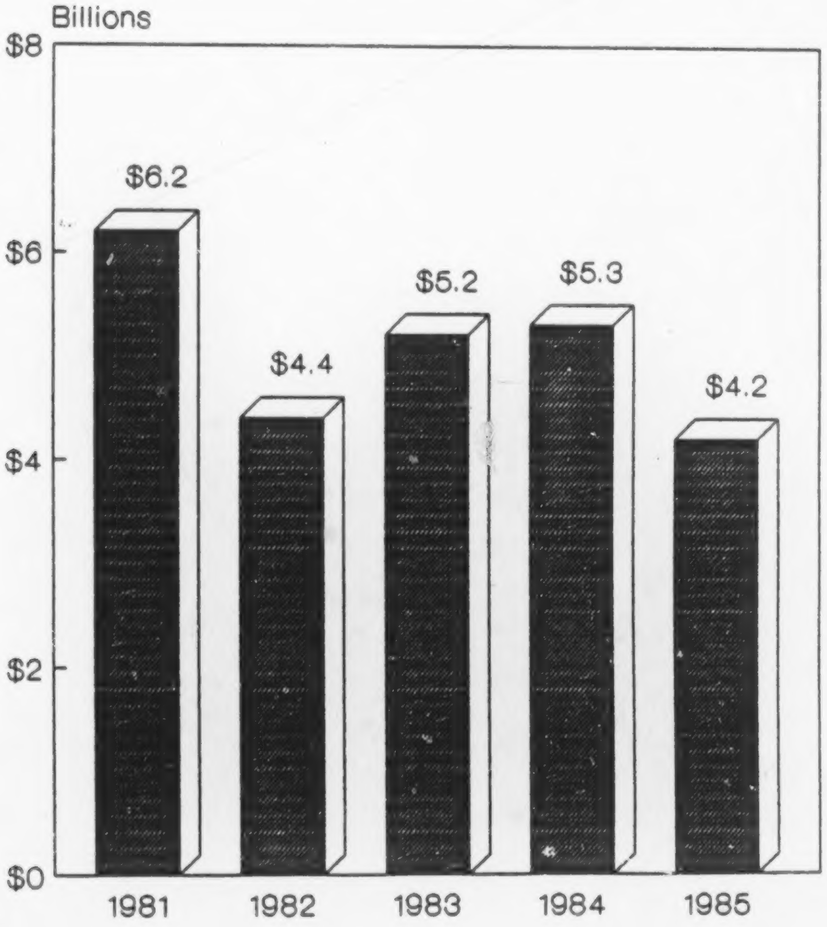
Source: World Bank Debt Tables

GROSS EXTERNAL LIABILITIES, 1980-1985
ARGENTINA, MEXICO, BRAZIL



Source: World Bank Debt Tables

U.S. AGRICULTURAL EXPORTS TO LATIN AMERICA



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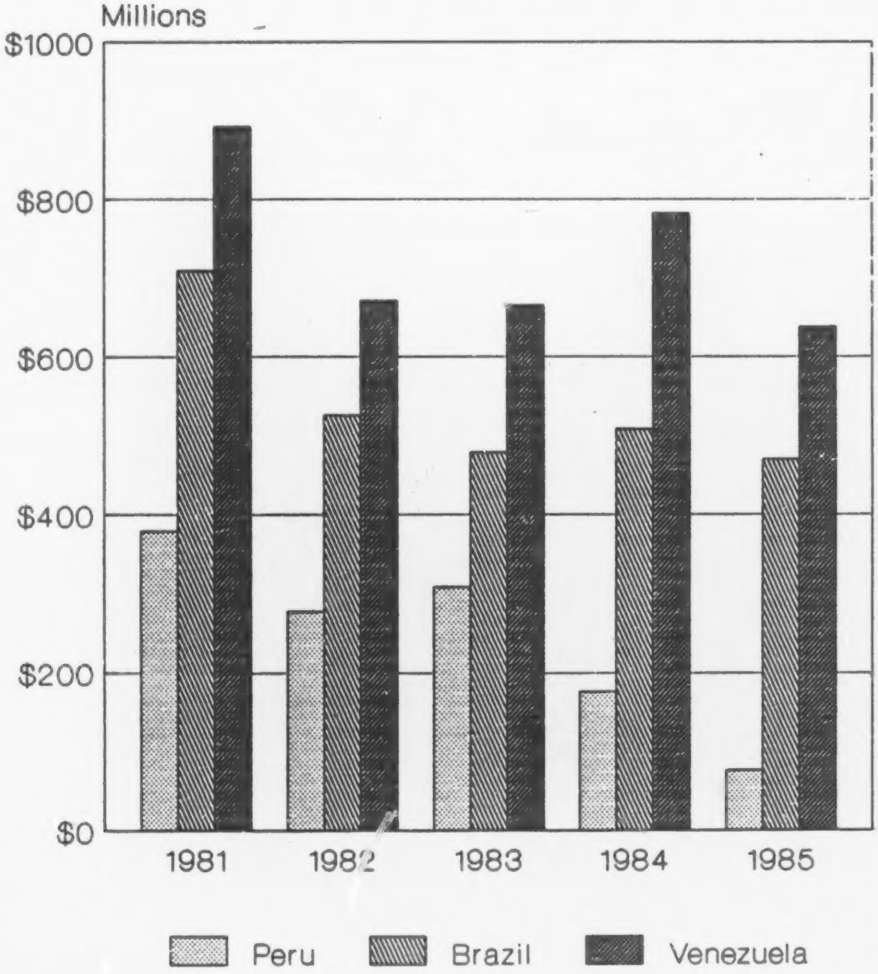

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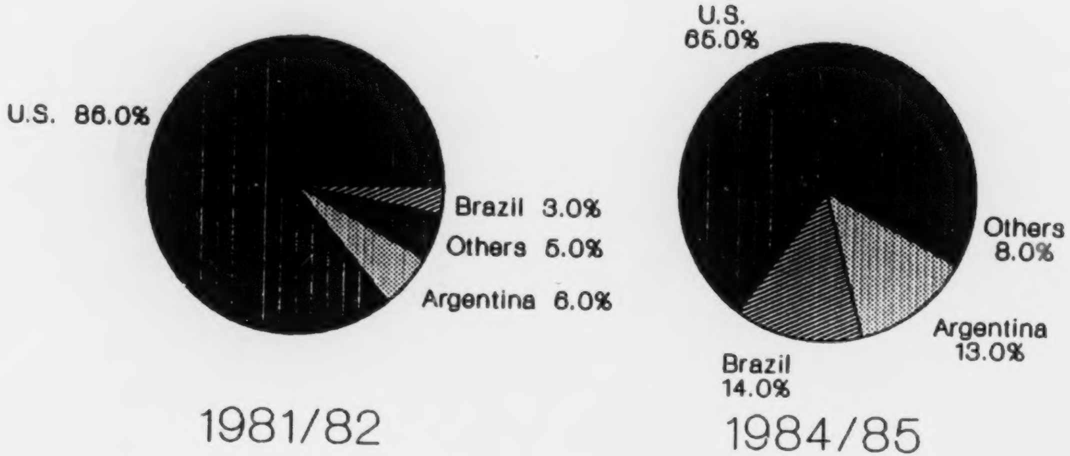
SOYBEAN EXPORTS BY VOLUME
PERCENT OF WORLD MARKET



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SOYBEAN MEAL EXPORTS BY VOLUME
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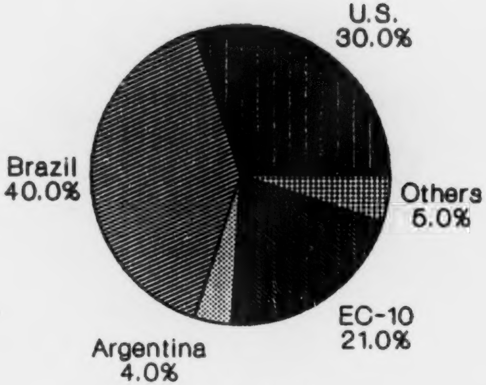
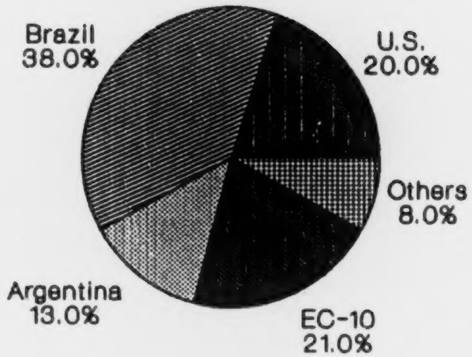


1981/82



1984/85

Source: USDA

SOYBEAN OIL EXPORTS BY VOLUME
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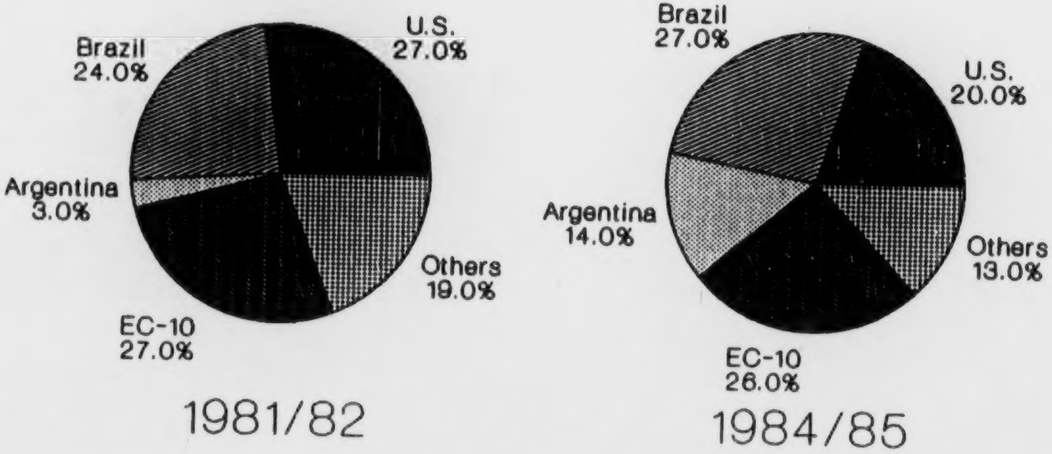

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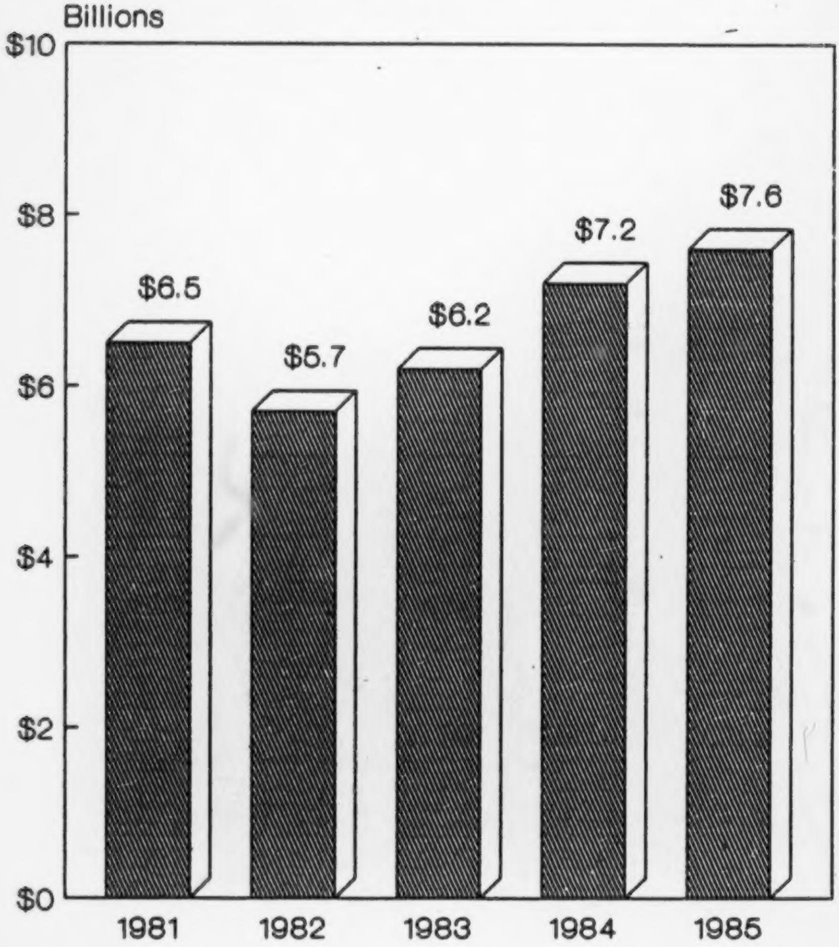
U.S. AGRICULTURAL IMPORTS FROM LATIN AMERICA, 1981-1985



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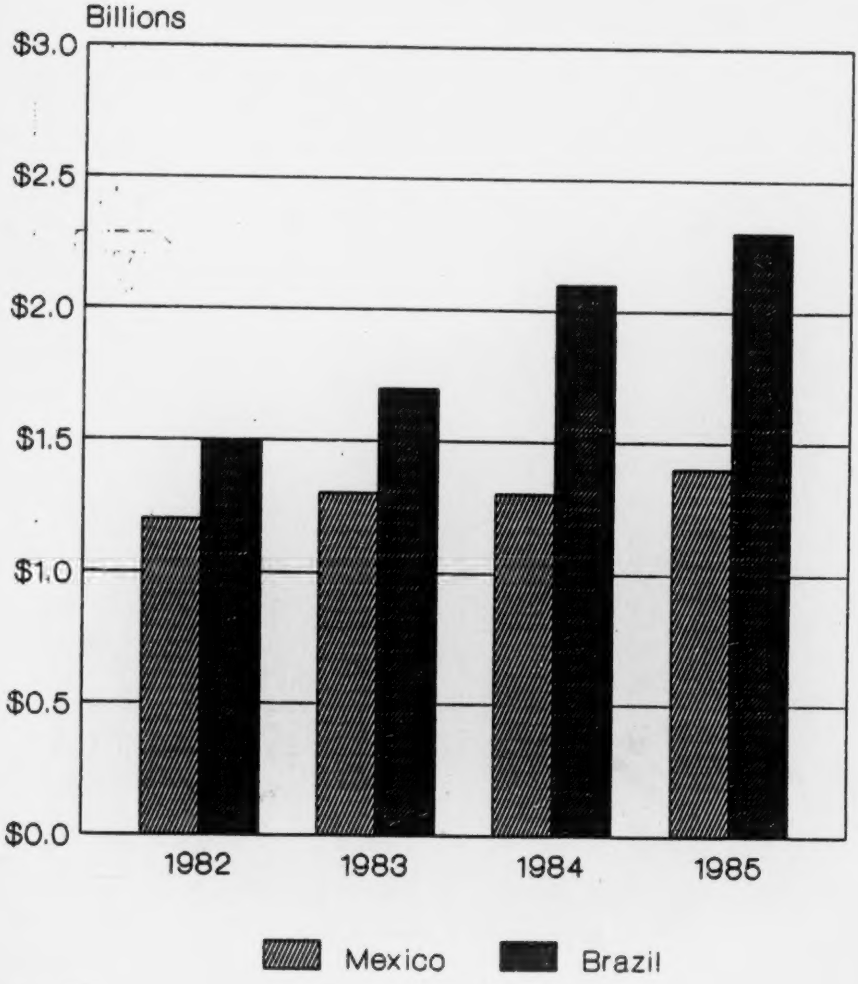
U.S. AGRICULTURAL IMPORTS FROM MEXICO AND BRAZIL



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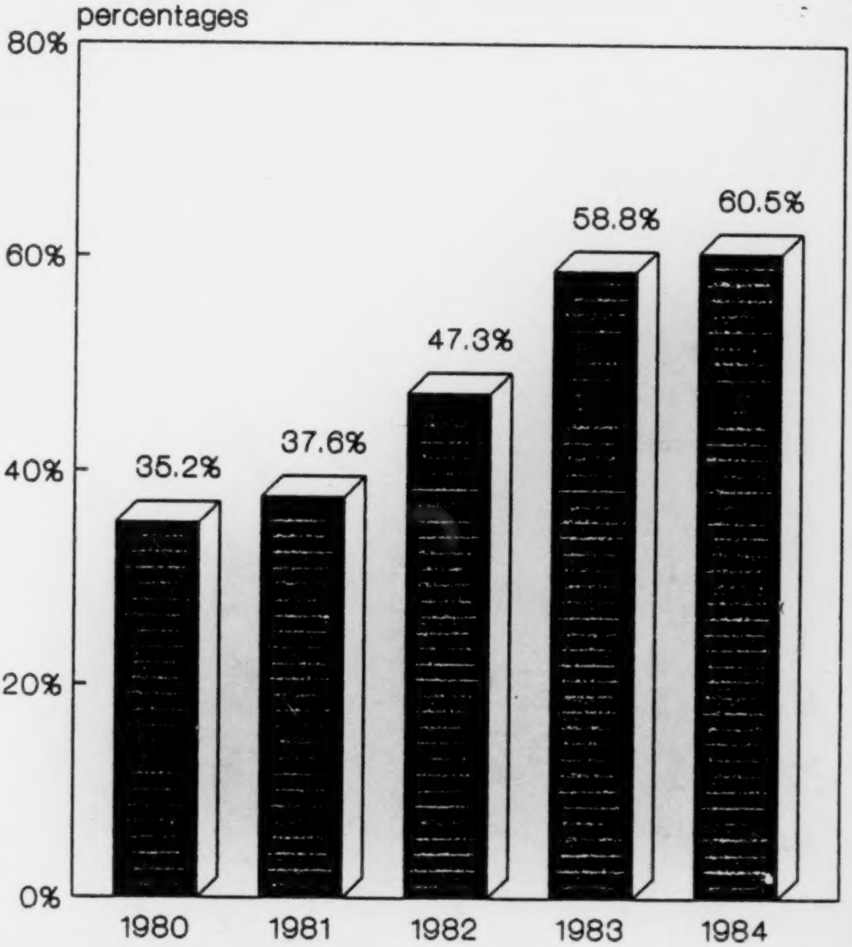
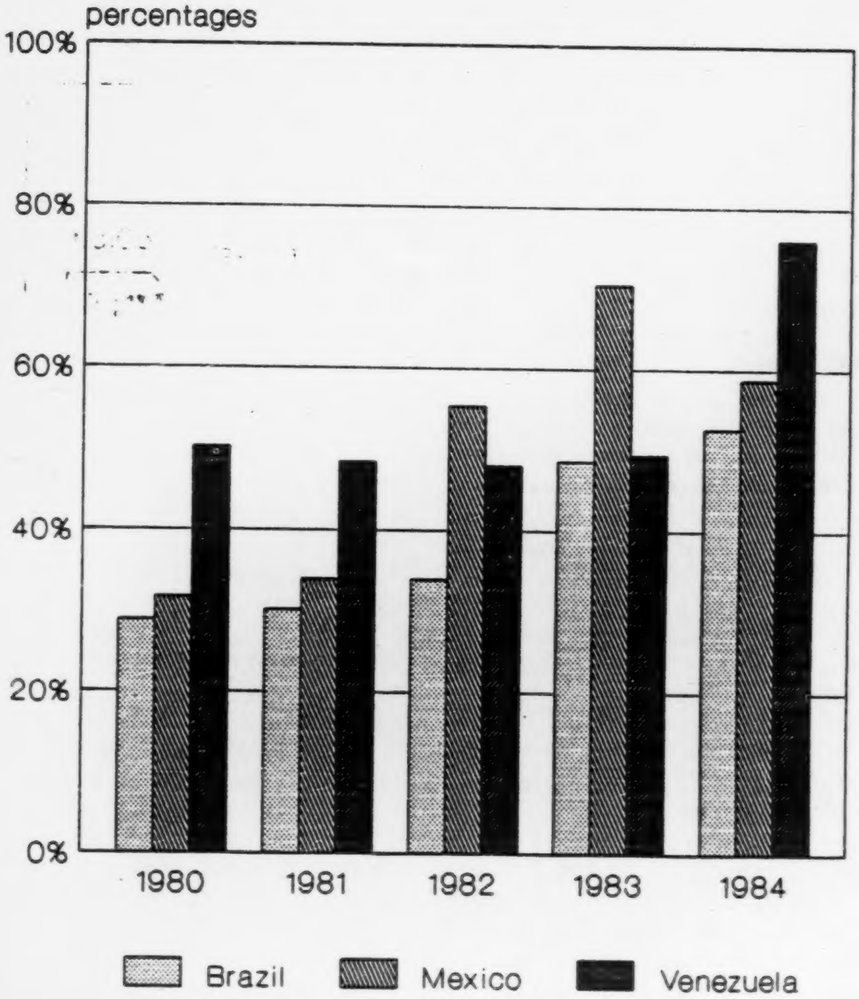
RATIO OF TOTAL DEBT TO GNP LATIN AMERICA



Source: World Bank Debt Tables

RATIO OF TOTAL DEBT TO GNP SELECTED LATIN AMERICAN COUNTRIES



Source: World Bank Debt Tables

STATEMENT OF LEROY WATSON, LEGISLATIVE REPRESENTATIVE, NATIONAL GRANGE, WASHINGTON, DC

Mr. WATSON. Thank you, Mr. Chairman. On behalf of the National Grange, I am pleased to have this opportunity to present our views on the problems of Latin American debt.

The Grange is this nation's first general farm and rural agricultural organization and, as such, we have had a long history of dealing with problems, both domestically and internationally. Debt problems both in Latin America and in U.S. agriculture were related to the heavy dependence on commodity prices as major sources of income. Lending policies in the 1960's and 1970's were based on the rising commodity prices and inflation. Few, if any, provisions were taken by lenders to guard against any significant changes in inflation or other macroeconomic policies.

When just such a series of macroeconomic policies changes occurred in the early 1980's, large amounts of debt were left that could not be supported in either Latin American countries or on U.S. farms. Overseas markets for U.S. commodities grew, and living standards increased as Third World economies grew in the 1970s. By the end of the period 1981 to 1985, however, the value of U.S. agricultural exports decreased by 28.7 percent. At the same time, the value of exports to Latin American countries decreased by 34.7 percent, which was a 21 percent greater market loss than the average for the time.

Part of the export loss can be attributed, we believe, to austerity programs that were imposed on debtor Latio American nations to increase their exports and decrease their imports in order to facilitate their ability to service their debts. This action helped increase their agricultural production and competition with U.S. farmers in world and domestic U.S. markets. The effect on U.S. agriculture was to magnify the collapse of farm sector equity and wealth.

Estimates of the amount of wealth that have been lost to U.S. agriculture in the last five years range between one-fourth and one-third of a trillion dollars. At the same time, political pressure has increased to transfer larger amounts of domestic income from the farm sector to make up for export income loss and to stabilize farm and rural economies. While the roots of domestic farm and Latin American debt problems may be similar, the policies to deal with the two debt crises have been as different as night and day.

In U.S. agriculture, the policy has been a painful restructuring of debts over the past five years, which has reduced the U.S. commercial farm debt from approximately $215 billion to $185 billion. At the same time, tens of thousands of family farmers have left their land. Commercial bank failures in the United States have reached unknown levels since the Great Depression.

On the 138 bank failures in 1986, approximately one-half were agricultural banks. Until late last year, no special Federally coordinated regulatory forebearance policy was in place to assist troubled agricultural banks. Contrast this with Latin American debt policy.

Restructuring of debts has increased the total Third World debt from approximately $752 billion in 1982 to $888 billion today. In Latin America alone, the U.S. commercial bank debt has increased from $82 billion to over $120 billion. Increased debts have increased the resources that are necessary to service those debts and have prompted counterproductive policies to reduce imports and increase exports in many nations. For U.S. banks, special regulatory forebearance has encouraged large U.S. banks to continue loaning to large debtor nations to maintain the fantasy that Third World debt is still carried at full value on their books.

Concurrently, the profits for the 10 largest U.S. commercial banks have been consistently strong for the years 1982 to 1985, with the notable exceptions of Continantal Illinois in 1984 and the Bank of America in 1985.

We believe that there was a primary difference in the policy objectives of the different debt crisis management strategies. For U.S. agriculture, the debt management policies—as painful as they are—have clearly fostered the goal of eventually producing a more efficient and prosperous farm sector. Coupled with the 1985 Farm Bill, our national goal is for family farmers to grow and profit from opportunities in the market. The Grange has supported these goals.

For Latin American nations, our goal has been debt servicing. While some discussion has been paid to encouraging economic changes in developing nations, the practical results have been different. It is clearly contradictory to encourage latin American leaders to move toward market-oriented policies while demanding that they adopt import/export policies which are geared not toward what the markets can bear but what debt they need to service.

Opportunities for productive U.S. exports, including agricultural exports, and opportunities for higher standards of living for citizens of developing nations were sacrificed to policies of increased debt and increased debt service.

The National Grange believes that encouraging growth and prosperity must be the primary U.S. economic policy toward Latin American nations. It is the deviation from that goal that has helped to put us in the situation we now find ourselves.

In his address to the delegates last year to the 120th annual session of the National Grange, National Master Edward Anderson highlighted the demonstrated win/win potential that exists for U.S. agriculture in Third World nations. He told our delegates: "Our country must encourage and support the feeding of the people and the economic development of the Third World countries. History has proven during the last 30 years that such programs eventually create a demand for an improved diet and the income to buy the food internationally, that they are unable to produce at home."

Mr. Chairman, we appreciate this opportunity, are willing to work with you and this subcommittee, and are pleased to answer any questions you may have.

Senator **Bradley**. Thank you very much.

[The prepared written statement of Mr. Watson follows:]

STATEMENT OF THE NATIONAL GRANGE

PRESENTED BY
LEROY WATSON
LEGISLATIVE REPRESENTATIVE

Mr. Chairman:

I am Leroy Watson, Legislative Representative for the National Grange. The National Grange was the Nation's first general agricultural and rural organization and currently represents approximately 400,000 members in over 4,500 local chapters in 43 states. We are pleased to have this opportunity to appear today to express our views on the problems of Latin American debt and U.S. agriculture.

Debt problems both in Latin America and in U.S. agriculture were related to the heavy dependence upon commodity prices as being major sources of income. Lending policies in the late 1970's were based upon rising commodity prices and inflation. Few, if any, provisions were taken by lenders to guard against any significant changes in inflation or other macroeconomic policies. When just such a series of macroeconomic policy changes occurred in the early 1980's, large amounts of debts were left that could not be supported in either the Latin American countries or on U.S. farms.

Overseas markets for U.S. commodities grew and living standards increased as Third World economies grew in the 1970's. By the end of the period 1981 to 1985, the value of U.S. agricultural exports decreased by 28.7%. At the same time, the value of exports to Latin American countries decreased by 34.7%, which was a 21% greater market loss than the median for the time.

Part of the export loss can be attributed, we believe, to austerity programs that were imposed on debtor Latin American nations to increase their exports and decrease their imports in order to facilitate their ability to service their debt. This action increased both production and competition with U.S. farmers in world and domestic U.S. markets.

The effect on U.S. agriculture was to magnify the collapse of farm sector equity and wealth. Estimates of the amount of wealth that was lost to U.S. agriculture in the last five years range between one-fourth and one-third of a trillion dollars. At the same time, political pressure has increased to transfer larger amounts of domestic income to the farm sector to make up for export income loss and to stabilize farm and rural economies.

While the roots of domestic farm and Latin American debt problems may have been similar, policies to deal with the two debt crises have been as different as night and day. In U.S. agriculture, the policy has been a painful restructuring of debts over the past five years which has reduced the U.S. commercial farm debt from $215 billion to $185 billion. At the same time, tens of thousands of family farmers have left their land.

Commercial bank failures in the United States have reached levels unknown since the Great Depression. Of the 138 bank failures in 1986, approximately one-half were agricultural banks. Until late last year, no special federal-coordinated regulatory forebearance policy was in place to assist troubled agricultural banks.

Contrast this with Latin American debt policy. Government-sponsored restructuring of debts has increased the total Third World debt from $752 billion in 1982 to $888 billion today. In Latin America alone, the U.S. commercial bank debt has increased from $82 billion to over $120 billion. Increased debts have increased the resources that are necessary to service those debts and has prompted counterproductive policies to reduce imports and increase exports in many nations.

For U.S. banks, special regulatory forebearance has encouraged large U.S. banks to continue loaning to large debtor nations to maintain the fantasy that Third World debt is still carried at full value on their books. Concurrently, profits for the 10 largest U.S. commercial banks have been consistently strong for the Years 1982 to 1985 with the notable exceptions of Continental Illinois in 1984 and Bank of America in 1985.

We believe that there was a primary difference in the policy objectives of the different debt crises management strategies. For U.S. agriculture, the debt management policies, as painful as they were, have clearly fostered the goal of eventually producing a more efficient and prosperous farm sector. Coupled with the 1985 Farm Bill, our national goal is for family farmers to grow and profit from opportunities in the market. The Grange has supported these goals, even as we have questioned the wisdom of some of the methods by which to attain them.

For Latin American nations, our goal has been debt servicing. While some discussion has been paid to encouraging economic changes in developing nations, practical results have been different. It is clearly contradictory to encourage Latin American leaders to move toward market-oriented policies while demanding that they adopt import/export policies which are geared not toward what world markets can bear but what debts they need to service. Opportunities for productive U.S. exports, including agricultural exports and opportunities for higher standards of living for citizens of developing nations, were sacrificed to policies of increased debts and increased debt servicing.

The National Grange believes that encouraging growth and prosperity must be the primary U.S. economic policy toward Latin American nations. Deviation from that goal has helped to put us in the situation we now find ourselves in. To the extent that large amounts of foreign debts stand in the way of achieving that goal, they must be restructured or eliminated. We have no specific recommendation to make on how to best make the transition from a debt servicing to a market-oriented growth policy for Latin America. But, in answer to the question as to whether or not such a transition needs to take place, we can clearly answer "yes".

In his address to the Delegates last year at the 120th Annual Session of the National Grange, National Master Edward Andersen highlighted the demonstrated win-win potential that exists for U.S. agriculture and Third World nations. He told the Delegates:

> "Our country must encourage and support the feeding of the people and the economic development of Third World countries. History has proven during the last thirty years that such programs eventually create a demand for an improved diet and the income to buy the food (internationally) they are unable to produce (at home)."

Mr. Chairman, we have appreciated the opportunity to present our views and are willing to work with this Subcommittee in developing constructive policy. I would be pleased to answer any questions that you may have.

Senator BRADLEY. I want to thank the whole panel for their testimony. It might appear that there is a blizzard of numbers hitting us in very short order, but we will have a chance to filter it. And I think that the message is an interesting one, an important one.

Mr. Brownback, you have talked about it as the Secretary of Agriculture of a major farm State, and you say that you have seen the export markets for Kansas wheat essentially disappear. Is that correct?

Secretary BROWNBACK. Well, certainly a precipitous fall. We experienced a decrease of wheat and flour exports of 40 percent from 1981 to 1985. I would call that a free fall downward.

Senator BRADLEY. And that is targeted into the Latin American markets?

Secretary BROWNBACK. A great deal of it was. It wasn't all, and it doesn't all go to Latin American markets; but a major portion of it goes to developing countries, and a good portion of that was the Latin American market, which has virtually dried up.

Senator BRADLEY. And at the same time that you have seen your export markets dry up, you have seen this shift in the farm balance—the trade balance—from $27 billion in surplus in 1981 to an $11 billion surplus in 1985; and that means an increase in imports into the United States as well?

Secretary BROWNBACK. A tremendous increase. And like I said, we import $20 billion worth of foodstuffs into this country, and my farmers and I don't understand that. We don't understand a policy that, in the 1960's—and we were proud of this—that Dr. Norman Borlog and others developed a "green revolution" to teach countries how to feed themselves. The saying at that time was: "Give a man a fish and you feed him for a day. Teach a man to fish and you feed him for a lifetime." Well, we taught them to fish, and we were proud of that fact. Normally, that helps those countries develop and import more of our food then. Eventually in the long term, we help each other—a win/win situation.

Instead, the situation has turned around where they are not producing for themselves but forced to produce for an export market while their people starve.

Senator BRADLEY. In your testimony you refer to a cartoon that was in a Brazilian magazine. You might share with us how that picture is worth a thousand words or more.

Secretary BROWNBACK. I thought it was interesting. It was in the Brazilian magazine "Interior" in January 1985. The line under it was in Portuguese, which I do not speak, but the drawing spoke of the cartoon which showed a starving Brazilian farmer watching a shipload of protein-rich soybeans leave the port for export. I think it spoke a thousand words right there.

Senator BRADLEY. In other words, the cartoon portrayed the decision on the part of a Third World government to export soybeans as opposed to having the soybeans at home for domestic consumption?

Secretary BROWNBACK. And when they have a starving population—the figure I have—of 23 million. To export protein-rich soybeans, competing against us, while their people starve is a sinful policy.

Senator **Bradley**. And Mr. Adams, is that what you were speaking of earlier?

Mr. **Adams**. Yes, sir.

Senator **Bradley**. Can you talk a little bit about some specific examples of soybean farmers in the last four or five years?

Mr. **Adams**. I can give you some prices as to what has happened. Of course, we talked about the market shift already, but just August, two years ago, I was receiving about $8.00 per bushel for my soybeans, and now we are down in the $4.00 range. And production domestically has not increased. So, what we have actually seen is our markets just displaced and some of them by—I like your term:—exporting. For example, the Brazilians will take—and don't hold me to these figures—but $100 worth of soybeans and process them and put them on the world market for $95.00. What they are essentially trying to do is generate currency to service debt.

Senator **Bradley**. So, what you both are saying in tandem is that, on the one hand, American farmers have lost their export market——

Mr. **Adams**. Yes, sir.

Secretary **Brownback**. Yes.

Senator **Bradley**. And at the same time, Third World countries have flooded the world market with excess supply, and that means a lower price for American farmers, in addition to no market. Is that correct?

Mr. **Adams**. Yes, sir. And in effect, what they are having to do is to sell—no matter what the price is—they are having to sell in order to generate the currency; and so, we have a constantly—both sides are undercutting each other as the price goes down.

Senator **Bradley**. I want to come back for another round. Senator Rockefeller?

Senator **Rockefeller**. Thank you, Mr. Chairman. Mr. Beckman, I guess it is fairly well understood that, if the world trading system is going to work, we have got to be healthy and other countries have to be healthy. If they are not, then they are not going to be able to buy our products; and if we are not, we are not going to be able to do what we should. How do you describe the interrelationship of countries' economic health to a stabilization of the world trade situation? This is a philosophical question.

Mr. **Beckman**. That is a rather philosophical question. Certainly, the United States has the largest economy in the world, the wealthiest economy in the world. It plays an important role in determining the economic health of the world community. We are a major market for the exports of Latin America and Europe, Canada and Japan. Without a strong U.S. market, those countries are not able to sell in this country. They are not able to earn the money to finance their own economic development and growth.

The United States is an important, essential market for other countries to maintain their growth. So, on that side of it, we certainly need to be a strong, healthy economy for everyone to benefit. At the same time, the United States, in order to remain strong, has to be a strong producing nation, and that goes for industrial goods as well as agricultural goods. And in order to maintain the high levels of productivity, the high wages that make the American standard of living what it is, and make it possible for Americans to afford the goods that are made in other countries, we have to be strong producers in high technology, high productivity industries; and we are going to have to be exporters in those industries in order to pay for the goods that the United States is importing. The way things are now, there are not sufficient markets for those goods in other countries because they are either suffering under austerity measures—as in Latin America—or they have closed their markets to competing American goods in order to foster the development of their own industries.

It is a situation that is leading us toward what we consider to be an impoverishment of the American economy and of the American public. That is something that is not in the interest of the United States. It is not in the interest of any of the other countries that are anxious to export to the United States. And we need to restore some balance to our trade to encourage the domestic growth of other economies and the ability of the United States economy to improve its productive capacity as well.

Senator **Rockefeller**. All right. And following on that then, if there has been a reduction in auto exports and an increase in imports into our country—and there is no question about that, since I know perfectly well from my own State of West Virginia the devastating effects of layoffs in steel and autos—that international debt is not the only problem. I mean, there is the dollar/yen relationship with respect to the Japanese. There is the whole question of a, frankly, overvalued dollar for a long period of time, and there is simply the question of Japanese exports.

In Peru, back in the early 1970s, I would guess there were very few, if any, Japanese cars because the Japanese weren't making cars at a sufficiently economic or qualitative rate to be bought; but now that is very different. We put on VRA's—voluntary restraints—and I support those. Don't you suppose that in this interrelationship between economies, as we restrict Japanese automobiles, for example, coming into this country or they voluntarily restrict their own exports under pressure from us, that some of the production of the Japanese automobiles industry finds its way increasingly into, for example, Peru and other Latin American countries?

Mr. **Beckman**. The auto industry is a very complicated industry internationally. You have to look at what Japan did in the 1940's, 1950's, and 1960's. Japan's market was absolutely closed to imports from any place. United States companies had produced cars in Japan in the 1920's, and they were kicked out in the 1930's. The industry was developed using government policies which created that result. So, we are not talking about a situation that has relied on market forces over the past 50 years to develop who is strong and who is weak in the industry. Certainly, the debt problems of Latin America are not the only problems facing the American auto industry in its exports. However, there are government policies in Latin America which prohibit American industries from exporting on a competitive basis to those countries. In fact, I have a clipping of recent date from the Journal of Commerce that has a listing of which products Brazil in January restricted from entry into that country in order to increase its trade balance.

Senator **Rockefeller**. I understand that. You mention in your testimony Brazil and, implicitly the law of similars. They have an anti-import policy as do others. Other than Brazil, in that part of the world, are there in addition to general anti-import policies, specific restrictions on imports of American automobiles, or pricing policies, or quota policies or some other policies which keep our automobiles out, even if they are competitive?

Mr. **Beckman**. The major markets for the auto industry in Latin America are Mexico and Brazil. Those are the largest, wealthiest countries which have their own domestic industry; and the American companies are producing there as well as companies from around the world. In Mexico, there is a specific auto decree which regulates what kind of investments you can make in that country, what you can produce, how much you can import, how much you are required to export. Those are nonmarket decisions. They are responses to government policies. The same way in Brazil, as you mentioned—there is direct government intervention in order to assure that domestic production rather than imports supply a large part of the parts market. And in Brazil, it is largely auto parts, rather than assembled vehicles that are the source of U.S. exports. So, it has been a conscious decision on the part of the Brazilian government to replace, as you said, those imports with domestic production. That is not an economic decision; it is not a classically economic decision. It is a decision on the part of the government of Brazil that it needs the export earnings that are available from auto parts exports and that it cannot afford to use valuable dollars to buy auto imports, when they have the capacity of building up their own industry.

I would like to comment also on what the other agricultural people have said that it is a shame that the development that is going on in these countries is oriented towards the export market rather than towards supplying the domestic market. We find the same thing in industrial goods as well. Rather than trying to increase the earning power of their citizens, rather than trying to improve the living standards that are available to their people, they are being put in a position by the banks, by the IMF, and international institutions to orient their whole development policy towards increasing exports and diminishing imports; and that is not productive for the people of those countries.

They are suffering greatly, as the previous panel described. The suffering is just heart-rending.

Senator **Rockefeller**. Thank you, Mr. Chairman.

Senator **Bradley**. I would like to ask a few more questions, and then Senator Rockefeller, if you would like to come back for a second round, we can do that.

Mr. Adams and Mr. Brownback, again on the question of the farm sector, you have testified that you have seen the export markets dry up and you have seen prices drop in large part due to oversupply in the world market, related to panic exports of agricultural goods to get the dollars needed to pay the interest. Now, what do you see as the relationship between that situation and the U.S. budget deficit, in particular in relation to the farm programs that Congress has enacted and that increase as the Congress tries to take account of the hard times that American farmers have fallen upon? Mr. Adams?

Mr. **Adams**. I don't think there is any doubt that there is a relationship because of the fact that the profits are there, and somehow, in order to keep the infrastructure in place, there have to be some funds coming in. I guess what it really boils down to, Senator, it looks to me like the vulnerable parties wind up paying in this situation. If you look at the bank relationship that our farmers have with their local banks, the vulnerable party in this case—the weak party—is the farmer who loses his land. And this is the way we have had this debt written down domestically.

It has been written down at great cost to the farm sector and to the farm banks and what have you. And I guess our real problem is that we have not had a like write-down on the international scale and facing the realities we have domestically. The vulnerable parties in this case, I assume, are the banks themselves because it is going to be very difficult for them to foreclose on a country as the local banks do in our case. So, at some point, we have to have an accommodation so that the real world comes back—so that we can get back to the real world and get rid of deficits, too.

And I guess what I am saying is that we recognize these payments to we farmers has to be transitory, but we have to have a goal of somehow getting out of this situation. And if this Third World debt situation is not corrected, I don't see anything but you increasing payments to us, to keep the infrastructure in place.

Senator **Bradley**. Mr. Brownback?

Secretary **Brownback**. Senator, we presently need the payments to be able to support and keep people farming, and we are still losing them in record numbers even with the structure that the U.S. Government has put into place. We see as a way to get away from those payments a twofold thing: one, if we can increase the exports, and that is going to be something that will be a long term. It may not be the spectacular growth that we had in the 1970s; and second, we recapture our own domestic market. If we are importing $20 billion worth of foodstuffs, if we could get half of that back, it could help us tremendously in being able to support ourselves and get away from the support structure that the Federal Government has in place. So, that is what I see as the goal.

This type of thrust in the Latin American debt crisis can help twofold: one, in increasing the exports that would be going normally to developing countries as they are in other places; and second, decreasing their exports into this country so that we can recapture more of our own domestic food market.

Senator **Bradley**. Mr. Watson, do you agree with those assessments, that if we are able to increase our exports and if we were able to recapture more of our domestic market—and I think by implication—if the world wasn't in a condition of oversupply because of the flooding of the agricultural markets, that indeed the amount of subsidies that go to farmers would be less because they would be more prosperous?

Mr. **Watson**. I think that is fundamentally true. As I said in my testimony, part of the problem that we have with the clamoring toward increasing the transfer of domestic income to the farm sector comes from the fact that we have lost income from the export sector. You can tie that very, very closely together. Also, on the other hand, what we need to understand is that the equity problems in agriculture that we have—and I touched on it in my testimony—are somewhat related to the prices of the commodities on world markets in that the underlying value of the resources in our foreign sector—the land, the buildings, the machinery—are dependent upon what return they can generate, as any other investment would be.

To the extent that we are continuing to have increasingly lower and lower commodity prices based on world markets because of the flooding of those markets from Latin American countries, we continue to have an erosion of that equity base. For an example, if we have only a five percent erosion of the equity base this year, it would wipe out the cost of the Farm Bill.

Senator Bradley. Say that again.

Mr. Watson. If we have a five percent erosion in the farm equity base this year overall.

Senator Bradley. In other words, if the value of the farm—land, equipment, et cetera—decreases by five percent because there is no prospect for reasonable price——

Mr. Watson. That loss in equity value would, to the best of my calculations, equal or exceed the amount of money we are going to be pumping into the farm economy through the Farm Bill.

Senator Bradley. So, we would be back to square one.

Mr. Watson. Right.

Senator Bradley. Since we are where we were when we began looking at the Farm Bill in 1985.

Mr. Watson. It is certainly tough to tread water in rapids. [Laughter.]

Senator Bradley. That might be an interesting metaphor we can use for the theme of this hearing. Senator Rockefeller?

Senator Rockefeller. One quick question, Mr. Chairman. Secretary Brownback, you referred to the green revolution. I am curious as to why it hasn't had more of an impact in the South American countries that we are talking about. For example, Dr. Norman Borlog, whom you referred to, began his work in Mexico; and the green revolution has worked spectacularly in Africa, India, the Philippines, and now in China. Why not in South America?

Secretary Brownback. For the reasons I stated in my testimony, Senator. They are producing for an export market rather than for their own internal consumption and building up their own per capita living base and their own people's livelihood, such as they are in India, the Philippines, and China. And you can see it has helped a great deal in a lot of those countries; but that is the reason, and that is what Dr. Parrlberg, who is an authority on agricultural policy—that I state on page 2 of my testimony—says that we are in partnership with these developing countries; and if we can get their farmers and their farm base to develop more, their consumption will increase and they will move from cereal grains to poultry consumption. That poultry consumption will consume more corn, milo, soybeans and such that their standard of living will rise; and they will need to import grains from us or other exporting countries to be able to increase that standard of living.

And that has worked in a lot of those countries, except in Latin America where they have been forced, instead of helping themselves and growing their own consumption and their own way of living and standard of living raising, that they have been forced to produce for an export market.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Senator BRADLEY. If I could just follow with a couple more questions in the remaining time I have. This has been a very interesting panel I think. I think frankly many people in the Senate would like to hear what you have said today, in terms of the relationship between this issue and the farm sector in particular. And it seems to me that in the last round of questions that there is also a direct relationship between the debt issue and the budget deficit, that the budget deficit is higher today than it otherwise would be if American farmers had export markets and had a reasonable price. And I think Mr. Watson then tied that even to the equity value of farms and the 1985 Farm Bill.

Mr. Brownback, in your testimony, I would like to just read a sentence of yours and have you interpret it. It relates to whether rural banks have had a different circumstance in coping with farm debts than have banks that are involved in the Third World debt issue.

And you say: "Rural Kansas banks would find it difficult to survive if their response to farmers who could not pay their loans was to loan them even more money they could not repay. Some might even find that downright silly, where the rural Kansas banks find it necessary to renegotiate those troubled loans to find a way for the farmer to reduce rather than increase debt."

Now, how is that related to the present debt crisis?

Secretary BROWNBACK. As far as it relates to the farm sector debt crisis, we have seen it fall from roughly $220 billion in debt in the farm country—the farm debt of the U.S.—to $185 to $189 over the past three to four years. So, you have seen a falloff, and it is continuing down as they rework.

Senator BRADLEY. So, the total farm debt has decreased? And that is what Mr. Watson said, I think, as well.

Secretary BROWNBACK. That is correct, and it still has to decrease further. Most economists project another $40 billion needs to come out of it before we are going to be in a level situation where we can sustain the debt that we have incurred. It strikes me that the same situation should apply in the Latin American debt situation. If you don't have enough to repay it, how can you repay it if you are given more to repay?

Senator BRADLEY. Anyone else want to comment on that point? Mr. Watson?

Mr. WATSON. Yes. I think it is interesting to note that, even though total farm debt has come down, as the percentage of the underlying asset value that debt has actually increased in this time. In other words, the drop in asset value has been far more precipitous than has the drop in the debt value. So, we actually have a debt-to-asset ratio that has been increasing in agricultural and not decreasing, even though we have had the tremendous restructuring.

Senator BRADLEY. Could you relate that to the Third World debt at all? I mean, we see that the farm debt has decreased while Third World debt has increased. Now, it is a little difficult to have a debt equity ratio to a country, but do you have any comment on that? If you don't, don't worry about it. [Laughter.]

Mr. WATSON. I guess I would just as soon not worry about it.

Senator BRADLEY. All right. [Laughter.]

Mr. Beckman, just one question, and I would like to ask all of you this question. This is a panel that relates to external indebtedness of the country and Third World debt, but this is the Finance Committee which also has a Trade Subcommittee; and we are vitally interested in trade. We are headed toward a new round of negotiations in Uruguay. And I would like to ask each of you: Would you support offering debt relief to some of these countries in exchange for lowering the barriers in those countries to our exports of agricultural goods or industrial goods or whatever? Is that one of the goals that we should seek to pursue in the new round? Please answer as succinctly as possible.

Mr. WATSON. Yes, sir, we do believe it is. Our goal should be economic growth and prosperity; and to the extent that the debt is in the way of that, we need to either restructure it or remove it.

Mr. BECKMAN. That's awfully succinct. I think that that alone is not going to be a sufficient answer to the problem. I think we do have to convince the governments of Latin America that it is important to focus on their own domestic economic markets and that exporting their way out of this crisis is not going to be successful. The United States is not going to be able to export its way out of its trade crisis, and we have to focus more on our domestic markets as well.

Mr. ADAMS. We would agree that it is important on the GATT round, but also I think a further step is that these countries internalize their consumption of goods so that they would have a living standard for the people that is sufficient to keep them alive. They are starving people in some of these countries in order to generate that. And we would like to be able to redirect that as a part of the GATT agreement where they would internalize some of that export. So, that would make it stable for their democracy, and they would be friends of us eventually.

Secretary BROWNBACK. I would encourage debt relief for reduced barriers and also——

Senator BRADLEY. You would?

Secretary BROWNBACK. And in addition to that, not encourage the exporting countries to produce food for an export market. I think it needs to be twofold: that they reduce the barriers and also that they not be told they need to export more food for the world market. I would tie them both together.

Senator BRADLEY. Let me thank the panel very much. You have been very helpful, and I am sure that a number of Senators will be interested in this testimony. Thank you.

Our next panel, which will address the impact of debt on U.S. business, consists of Mr. Donald Fites, Executive Vice President of Caterpillar, Inc. of Peoria, Illinois; Mr. John Plunket, Director of Transmisiones y Equipos Mecanios in Mexico City; Mr. Phil LaRocco, Director, World Trade Department, Port Authority of New

York and New Jersey; and Dr. Margaret Daly Hayes, Director of the Washington Council of the Americas.

Let me welcome all of you to the Finance Committee today and to remind you that we are trying to follow a five-minute rule for your opening statements. If you hedge a few seconds or a few minutes, the chair will be lenient; but beyond that, Senator Rockefeller insists on having a rigid opening statement time. [Laughter.]

And then we will go to questions and answers. Let's begin with Mr. Fites. Mr. Fites, welcome to the committee. I think that your company certainly has had experience in the last four years with these issues. So, we look forward to hearing from you.

STATEMENT OF DONALD V. FITES, EXECUTIVE VICE PRESIDENT, CATERPILLAR, INC., PEORIA, IL

Mr. **Fites**. Thank you, Mr. Chairman, Senator Rockefeller. And let's see if somebody can make a five-minute statement.

My name is Donald Fites. I am Executive Vice President of Caterpillar Inc., with responsibilities for worldwide sales and marketing activities. I am pleased to be here today to comment on the impact indebtedness of developing countries is having on U.S. exporters. Anything that affects U.S. exports is vital to Caterpillar.

Last year, we ranked third among the 50 largest U.S. exporters in terms of U.S. exports as a percent of sales. About 75 percent of our worldwide sales are of goods produced at American factories. We are consistently one of the major contributors to the U.S. balance of payments, generally ranging from $1 billion to $2 billion a year.

The written statement I have submitted includes charts and specific examples which illustrate the decline of Caterpillar's U.S. exports to the major debt-burdened developing nations. Market barriers and recent overvaluation of the U.S. dollar are also important other reasons for this decline. I won't flood you with statistics now, but with the help of a graphic, let me give you an idea of the magnitude of the problem. The blue bars represent Caterpillar's machine exports—I am leaving out parts and components here—to 15 key developing countries with major debt problems, the so-called "Baker 15." The red bars show U.S. employment at both Caterpillar and at our U.S. supplier facilities generated by those exports. As you can see, the decline since 1980 has been dramatic, with our U.S. machine exports to those 15 countries falling 86 percent.

Caterpillar and supplier jobs in the U.S. that are dependent on those exports fell from nearly 12,000 in 1980 to about 1,200 in 1986. Now, one of the major trade problems causing this scenario is the fact that many developing countries are relying increasingly on market barriers on imported products to preserve scarce foreign exchange for debt servicing. For example, Caterpillar builds motor graders in Decatur, Illinois. These products are virtually locked out of Mexico; and there are many other examples.

Parenthetically, I was interested in one of your earlier witnesses who said that import barriers in Latin American countries are being dismantled. I would like to find those that are being dismantled. We haven't been able to, and we deal in all those countries.

Finally, policy makers should be aware of the fact that many U.S. exporters, including Caterpillar, also have direct financial exposure in developing countries. Caterpillar's exposure is more than $650 million. More than $300 million of this results from export trade receivables and support of our Caterpillar dealers' retail outlets.

I hope my remarks illustrate why Caterpillar is so interested in the international debt situation. We applaud your attention to this problem, and we will work with you in any way we can to help solve it. Before concluding, I want to make one last point.

It will probably be several years before debtor nations' demand for imports returns to prior levels. So, it is important that U.S. producers obtain a larger share of the demand that exists if we are to maintain our export base in this country. Caterpillar is undertaking strategies that will help us to do so by making sure our products are technologically superior and that our costs of manufacturing in the U.S. are competitive worldwide.

But there are also important external dimensions comprised of exchange rates. The dollar is still too strong. Export trade financing. We really haven't financed the Export-Import Bank budget or the so-called war chest to compete against the below rate financing by competitive countries. Export controls and trade sanctions continue to take a toll on our exports and our reputation as a reliable supplier. Tax policy and other issues are also vital to our export efforts.

We need to keep all of these issues in perspective as we consider our competitiveness in a global economy. Thank you.

Senator BRADLEY. Thank you very much, Mr. Fites. Mr. Plunket?

[The prepared written statement of Mr. Fites follows:]

Statement by

Donald V. Fites

Executive Vice President

Caterpillar Inc.

Mr. Chairman: My name is Donald V. Fites. I'm Executive Vice President of Caterpillar Inc. with responsibilities for worldwide sales and marketing activities.

Caterpillar is a multinational company which designs, manufactures, and markets products in two principal categories: earthmoving, construction, and materials handling machinery ... and engines for on-highway trucks, marine power, electric power generation, and other applications.

I'm pleased to be here today to comment on the impact indebtedness of developing countries is having on U.S. exporters. Anything that affects U.S. exports is vital to Caterpillar. Last year, we ranked third, among the 50 largest U.S. exporters, in terms of U.S. exports as a percent of sales. About 75 percent of our worldwide sales are of goods produced at American factories.

As you know, the total external debt of developing countries topped one trillion dollars in 1986. Clearly, that has global economic implications. Let me illustrate the impact on my own company with a specific example.

Mexico needs to become more self-sufficient in feeding its growing population. Under a project proposed by the Mexican National Agency for Production of Food Grains, more than one million acres were slated for agricultural development. This would have required land clearing, forming, and road construction -- the type of work Caterpillar equipment does.

But the project didn't get off the ground, mainly because of the Mexican debt situation. As a result:

- the Mexican people were denied needed development;
- Caterpillar lost more than $40 million in sales of U.S.-produced equipment;
- our factories in Illinois, Iowa, and Pennsylvania lost more than 300 man-years of labor; and
- Caterpillar's U.S. suppliers lost 600 man-years of labor.

This is just one of many such examples of lost opportunities for U.S. exporters.

The attached charts illustrate the decline of Caterpillar's U.S. exports to key developing nations. Market barriers and the recent overvaluation of the U.S. dollar are also important reasons for this decline.

The most significant impact has been on earthmoving and construction machines — products like track-type tractors, off-highway trucks and so on. These products are the lifeblood of Caterpillar. Since 1980 the decline in our U.S. machine exports to 15 key developing countries with major debt problems has been dramatic. Our U.S. machine exports to the countries have fallen 86 percent from $400 million to $55 million; Caterpillar and supplier jobs in the U.S dependent on those exports fell from nearly 12,000 in 1980 to about 1,200 in 1986.

Trade difficulties are compounded by the fact many developing nations are relying increasingly on market barriers on imported products to preserve scarce foreign exchange for debt servicing. For example, Caterpillar builds motor graders in Decatur, Illinois. But these products are virtually locked out of Mexico. That country does allow importation of certain wheel loaders and off-highway trucks we build in the U.S. — but imposes a high duty, 35 percent to 40 percent, depending on the model and size.

Argentina prohibits importation of some wheel loaders. So we've had to license an Argentinian firm to produce one of the more popular sizes. This has displaced jobs at Aurora, Illinois.

Finally, in considering the developing country debt problem, policymakers should be aware of the fact many U.S. exporters, including Caterpillar, have direct financial exposure in developing countries.

Caterpillar's exposure is more than $650 million. More than $300 million of this results from export trade receivables and support of Caterpillar dealer retail outlets.

I hope these comments illustrate why Caterpillar is so interested in the international debt situation. We applaud your attention to this problem, and will work with you in any way we can to be of assistance.

Before concluding, I would like to make one last point: It will probably be several years before debtor nations' demand for imports returns to prior levels. So it's important that U.S. producers obtain a larger share of the demand that exists, if we are to maintain our export base. Caterpillar is undertaking strategies -- plant consolidation and modernization, employee retraining, cost reduction and others -- that will enable us to do so. We intend to remain the technological leader in the industries we serve, and we continue to invest in modernizing U.S. manufacturing facilities to allow us to manufacture products in this country that are competitive worldwide. But there are also other vital external dimensions which, we believe, must be considered and include:

-- A further decline in the value of the dollar. Exchange rates should play a greater role in U.S. policies. The Treasury should be required to regularly update Congress regarding the value of the dollar and other currencies and the implications for trade balances.

-- Better export trade financing, including full funding of the Eximbank authorization of at least $1.1 billion and including the $300 million "war chest" to combat below-rate foreign export financing.

-- Stronger intellectual property protection, including protection of industrial designs.

-- Less restrictive export controls and the cessation of the use of trade embargoes and sanctions as the blunt edge of foreign policy.

-- Trade law reform aimed at improving U.S. access to foreign markets. At the same time, trade law reform must be consistent with the need of U.S. manufacturers to retain access to fairly traded imports such as steel and machine tools.

-- And tax laws consistent with trade concerns. In particular, the U.S. Treasury later this year will report to Congress a study of the "source of income rules" for sales of inventory property. The existing source rules provide an incentive for exports, and should be maintained.

We need to keep all of these issues in mind -- as well as the developing nation debt problem -- as we consider our competitiveness in a global economy.

TABLE 1: Caterpillar U.S. Machine* Exports
(Millions of $s, Net Sales)

Year	To Key** Debt-Burdened Developing Nations	To All Other Developing Nations
1980	$400	$625
1981	440	960
1982	185	570
1983	60	270
1984	75	320
1985	65	370
1986	55	290
1980-86 decline	86%	54%

*Earthmoving and construction prime product

**Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Ivory Coast, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, Yugoslavia

TABLE 2: Caterpillar U.S. Machine Exports And Jobs*

Year	Jobs Dependent On Total U.S. Machine Exports	Jobs Dependent On U.S. Machine Exports to Key Debt-Burdened Countries	
		Number of Jobs	As % Of Jobs Dependent On Total U.S. Machine Exports
1980	48,700	11,800	24%
1981	53,100	11,700	22%
1982	32,400	6,000	19%
1983	18,000	1,800	10%
1984	18,700	2,100	11%
1985	18,900	1,700	9%
1986	15,200	1,200	8%

*Includes Caterpillar and U.S. supplier firms

STATEMENT OF JOHN T. PLUNKET, DIRECTOR, TRANSMISIONES Y EQUIPOS MECANIOS, MEXICO CITY, MEXICO

Mr. PLUNKET. Thank you, Mr. Chairman. I appear on behalf of the American Chamber of Commerce of Mexico and the Association of American Chambers of Commerce in Latin America. I am past president of both organizations, and I am currently Chairman of the committees from both organizations which deal with international trade and investment. The memberships of both organizations are composed basically of American business and professional men resident in Latin America and of national businessmen who are interested in trade and investment between their countries and the United States. We are, essentially the people who do the trading—in both directions—and who make and manage U.S. investment in Latin America.

We are, therefore, particularly concerned about the effect of the debts of the Latin American nations on the ability of those countries to buy goods from the United States. U.S. exports to Latin America in 1981 were worth almost $42 billion; but in 1982, the Latins discovered that they were rapidly running out of both money and credit, and their purchases of U.S. goods fell to $33 billion, a decline of almost $9 billion. Those purchases fell further in 1983 to $25 billion. Since then, there has been a modest recovery to $29 billion in 1984 and a little more than $30 billion in each of 1985 and 1986, but our sales are still some $12 billion less than the 1981 figures.

This decline in export sales has obviously had an adverse effect on the balance sheets and income statements of a good many American corporations. However, the effect of the lost sales, which we believe most clearly illustrates the importance of Latin American trade to the U.S., is the effect on U.S. jobs. This has been discussed by other witnesses, and I shall not belabor the point.

However, I think it might be pointed out that while we hear and read a great deal about the loss of U.S. jobs resulting from the importation of foreign products into this country, studies by the U.S. Department of Commerce show that the decrease in export generated jobs accounted for 80 percent of the total U.S. decline in manufacturing jobs between 1980 and 1984.

Now, Latin Americans have not reduced their purchases from the U.S. because they suddenly decided to buy more from Japan or Europe. We retained about the same percentage of the Latin American market which we have had in the past, but that market has shrunk drastically since 1981. It has not shrunk because the Latins did not want the things they were buying from us. They not only want the machinery, the steel and construction and agricultural equipment which they used to buy, but they desperately need these things if their economies are to grow sufficiently to provide the revenues necessary to give their people a higher standard of living and enable their governments to comply with their international obligations, including, not incidentally, their foreign debts. These people are caught in a classic vicious cycle. Their economies must grow if they are to service their foreign debt, but the burden of that debt service leaves them without the funds or the credit to obtain the tools which are necessary for economic growth.

The experience of Mexico, which takes over 40 percent of all U.S. exports to Latin America, gives an indication of the effect of debt service on a country's ability to import. In 1979 Mexico paid interest of $4.1 billion on a foreign debt of $42.4 billion. In 1986—just seven years later—it paid interest of $9.2 billion on debt of $97.8 billion.

Since the gravity of the debt problem became apparent in 1982, Latin American governments have made strenuous efforts to improve their trade balances in order to try and cover their debt service obligations. The reductions in imports, which were necessarily a part of those strenuous efforts, have resulted in substantial declines in the standard of living of the Latin American people, and those standards of living were already abysmally low.

But those reductions in imports have also meant that the jobs of people in other nations who would otherwise have produced the goods, constituting those unsold imports, have also suffered. And the United States has historically been the principal exporter to Latin America.

This is a situation in which there are no winners, and it is continuing to deteriorate. We Americans who see it happening are distressed, and we are greatly concerned about possible developments in the future. We are, however, encouraged that the situation is receiving the attention of this committee. And we are hopeful that some action will be possible to avoid or at least to alleviate the crisis which seems imminent.

Mr. Chairman, on behalf of the Association of American Chambers of Commerce in Latin America, we request permission to submit to the record a further detailed statement. Thank you, sir.

Senator **Bradley**. Your statement will be submitted to the record without objection. Mr. LaRocco?

[The prepared written statement of Mr. Plunket follows:]

Statement

John T. Plunket

on behalf of the

Association of American Chambers
of Commerce in Latin America
and the
American Chamber of
Commerce of Mexico

My name is John T. Plunket and I appear on behalf of the American Chamber of Commerce of Mexico and the Association of American Chambers of Commerce in Latin America. I am a Past President of both organizations and am currently Chairman of the Committees in both organizations which deal with international trade and investment. The memberships of both organizations are composed basically of American business and professional men -- resident in Latin American and of national businessmen who are interested in trade and investment between their countries and the United States. We are, essentially, the people who do the trading -- in both directions -- and who make and manage U.S. investment in Latin America.

We are, therefore, particularly concerned at the effect of the debts of the Latin American nations on the ability of those countries to buy goods from the United States. U.S. exports to Latin America in 1981 were worth almost 42 billion dollars, but in 1982 the Latins discovered that they were rapidly running out of both money and credit, and their purchases of U.S. goods fell to 33 billion, a decline of almost 9 billion dollars. Those purchases fell further in 1983 to 25 billion. Since then there has been a modest recovery to 29 billion in 1984 and a little more than 30 billion in each of 1985 and 1986, but our sales are still some 12 billion dollars less than the 1981 figure.

This decline in export sales has obviously had an adverse effect on the balance sheets and income statements of a good many American corporations. However, the effect of the lost sales which most clearly illustrates the importance of Latin American trade to the U.S. is the effect on U.S. jobs. We hear and read a great deal about the loss of U.S. jobs resulting from the importation of foreign products into this country. However, studies by the U.S. Department of Commerce show that the decrease in export penetrated jobs accounted for 80% of the total U.S. decline in manufacturing jobs between 1980 and 1984. In 1984 the Federal Reserve Bank of New York published the results of a study showing that the reduction of exports to Latin America from 1981 to 1983 had cost 400,000 American jobs. And in October of 1986, in an article in the Washington Post, Senator Bradley stated that "The loss of U.S. exports to Latin America since the onset of the debt crisis has destroyed 800,000 jobs."

The Latin Americans have not reduced their purchases from the U.S. because they suddenly decided to buy more from Japan or Europe. We have retained about the same percentage of the Latin American market which we have had in the past, but that market has shrunk drastically since 1981. It has not shrunk because the Latins do not want the things which they were buying from us. They not only want the machinery, the steel, the construction and agricultural equipment which they used to buy, but they desperately need these things if their economies are to grow sufficiently to provide the revenues necessary to give their people a higher standard of living and enable their governments to comply with their international obligations, including -- not incidentally -- their foreign debts. For these people are caught in a classic vicious cycle. Their economies must grow if they are to service their foreign debt, but the burden of that debt service leaves them without the funds or the credit to obtain the tools which are necessary for economic growth.

The experience of Mexico, which takes over 40% of all U.S. exports to Latin America, gives an indication of the effect of debt service on a country's ability to import. In 1979 Mexico paid interst of 4.1 billion on a foreign debt of 42.4 billion dollars. In 1986 it paid interest of 9.2 billion on debt of 97.8 billion.

We, the Association of American Chambers of Commerce in Latin America, respectfully request permission to submit for the record a further, more detailed statement which will reflect the views of our members as to possible legislative action which we feel would be in the best interest of both the United States and the nations of Latin America.

Thank you.

STATEMENT OF PHIL LaROCCO, DIRECTOR, WORLD TRADE DEPARTMENT, PORT AUTHORITY OF NEW YORK AND NEW JERSEY, NEW YORK, NY

Mr. LAROCCO. Thank you. The Port Authority was created in 1921 and is responsible in the New York/New Jersey region for all of the tunnels and bridges between the States of New York and New Jersey, the port facilities on both sides of the Hudson River, the three major airports in the New York/New Jersey area, the World Trade Center, and a network of industrial parks and other regional development proects, including Teleport, an international telecommunications facility.

In addition to this network of facilities, we conduct an expensive trade promotion and economic development program, including the following: an export trading company; maintaining trade development offices in London, Zurich, and Tokyo; undertaking trade missions overseas; and conducting international market research to improve the competitiveness of our region's businesses. In addition, since 1978, we have been taking an active role in the solicitation of foreign direct investment in our region.

Our involvement in these facilities and activities speaks to the fact that international trade is vital to the economies of both States and has been vital for the development of the New York region since its beginnings. The New York Customs District handles almost 23 percent of total U.S. imports and 20 percent of total U.S. exports. The port industry accounts for approximately three percent of our gross regional product generating $14 billion in economic activity each year and producing a total of 191,600 direct and indirect jobs, including 48,000 involved in the physical handling of commodities and 55,000 involving trade-related services.

The aviation industry adds an additional 93,000 jobs and over $5.3 billion in economic activity. The involvement of our region's service sector in international trade, although not as well documented as our cargo and aviation activities, is probably even heavier, with two-thirds of the Letters of Credit generated by banks in our region applying to transactions which take place outside of the region, and five of the 10 major money center banks involved in lending to Latin America are located in New York City.

The Latin American debt crisis has direct implications for us in two important areas. First, we are in the business of moving goods and people through our port and airport facilities, and we want our markets to expand and not contract. Second, our health as a business—as a public agency—is dependent on the economic health of our region and its businesses—the importers, exporters, and financial institutions. And an important part of their business is Latin America.

After almost 20 years of uninterrupted high growth, real gross domestic product in Latin America held at 1.4 percent in 1982 and 2.4 percent in 1983. Developing Asia, by contrast, grew by 5.2 percent in 1982 and 6.3 percent in 1983. Since 1983, fortunately, we can report that Latin America's economic growth has resumed but at lower rates than before the recession. These two recession years, of course, coincided with the onset of the debt crisis.

In response to externally imposed austerity programs, foreign exchange constraints, and the requirements of domestic economic and political reform, Latin America dramatically reduced its imports. U.S. exports to the region, after growing several years at 20 and 30 percent rates, fell 23 percent in 1982 and almost 30 percent in 1983.

How did this collapse of what had traditionally been a major U.S. market affect the Port of New York/New Jersey?

In 1982, exports from our Customs District to the eight largest Latin American countries were down 22 percent. 1983 produced another 36 percent decline. Between 1981 and 1983, the value of New York/New Jersey exports to Mexico declined 78 percent, to Venezuela 60 percent, to Argentina 55 percent, and our tonnage was down similarly. Between 1981 and 1983, ocean-borne cargo from New York and New Jersey to Brazil dropped over 47 percent and to Peru 55 percent.

Similar declines were recorded by Miami and Houston also, which ranked first and second in terms of dollar trade with Latin America at port facilities. Given the timing and intensity of these shifts, the debt crisis appears to have had a major negative impact on the New York/New Jersey region's exports.

The trade barriers that Latin America debtor countries have imposed to put hold on their imports and preserve foreign exchange for debt payments have also adversely affected the operation of our programs to provide export assistance to small and medium sized companies. Last year, our three year old trading company made only one percent of its $12 million in sales to Latin America.

However, statistics are never as simple as they appear at first glance. Our decline in exports must be qualified for several very important reasons, since there are other factors strongly affecting our trade flows during this period. These include the dollar's increasing strength against even the Latin American currency and the fact that we were noncompetitive in holding our market share during this same period, losing shares to other American ports.

Finally, things could have been worse. We have been fortunate—more fortunate than the agricultural sector representatives today—in having a mix of trading partners and export commodities which cushioned us somewhat. The commodities our region tends to sell to Latin American countries are largely manufacturing imports—paper and cardboard, chemicals, plastics, and machinery—rather than the agricultural products which have been harder hit by the shrinkage of their markets.

To summarize, given the three-pronged assault of debt constraints, currency shifts, and shifting port markets, it is not possible to specifically assign a dollar figure to the impact of the debt crisis on our export business. We are, however, deeply concerned about the decline—actual and potential—of our region's export markets in Latin America. Without a sustained recovery of growth and investments in those countries, it is hard to imagine a significant recovery of our region's markets.

And a final note is that there is some good news from an importing perspective. All of the bad news you have heard about the pressure on Latin American countries to increase their exports has, in fact, increased the amount of import traffic through the Port of New York/New Jersey from the narrow perspective of operating cargo facilities. As we said in our testimony, we have to confess to the position concerning the subject of Latin American debt to the following. We have met the special interests, and they are us.

As exporters, we would like to see a resolution that restores growth and investment to our Latin American trading partners. As importers, we would like to see a resolution that does not impede or reduce the flow of Latin American products through our facilities to our producers and our region's producers.

And finally, as a major center of the financial industry, we would like to see a resolution which does not impair the balance sheets of our major banks. All in all, not asking too much, Senator. [Laughter.]

I would like to thank you for the opportunity to share our views. And further, I would like to apologize for Steve Berger, who was not able to attend today, because of a family illness. Stephen Berger is our Executive Director, who had to stay in New York.

Senator BRADLEY. Thank you very much, Mr. LaRocco. Your testimony reminds me of some of the early testimony in tax reform. [Laughter.]

Dr. Hayes?

[The prepared written statement of Mr. Berger follows:]

TESTIMONY OF
STEPHEN BERGER
EXECUTIVE DIRECTOR
PORT AUTHORITY OF NEW YORK AND NEW JERSEY

I am Stephen Berger, Executive Director of the Port Authority of New York and New Jersey, a bi-state agency created in 1921 to operate the bridges and tunnels between the states of New York and New Jersey and the port facilities on both sides of the Hudson River. Today, the Port Authority also includes the three major airports in the New York/New Jersey area (John F. Kennedy, LaGuardia, Newark); most of the piers and port facilities; the World Trade Center; Teleport, the first international telecomunications center; three bus terminals; the trans-Hudson crossings and three industrial parks.

In addition, we conduct extensive trade promotion and economic development activities. These include an export trading company, trade development offices and missions overseas, international market research to improve the competitiveness of our region's businesses, and active assistance to the states of New York and New Jersey in obtaining foreign direct investment in our region's economy.

Our involvement in these activities arises from the fact that international trade is vital to the economies of both states. The New York Customs District handles almost 23 % of total U.S. imports and 20% of total U.S. exports. The port industry accounts for approximately 3 percent of the gross regional product, generating approximately $14 billion in economic activity annually and a total of 191,600 direct and indirect jobs. Of the 103,000 direct port industry jobs, 48,000 involved the physical handling of commodities and 55,000 involved trade-related services. The aviation industry generated 93,400 jobs and $5.3 billion in economic activity, over 1 percent of the region's gross regional product. The involvement of our region's services sector in international trade, although not as well documented, is probably even heavier. Over two-thirds of the letters of credit generated by banks in our region, for example, are for transactions which take place external to our region. And, as I'm sure you know, five of the 10 major money-center banks involved in lending to Latin America are located in New York City.

Thus, the Latin American debt crisis has direct implications for the Port Authority of New York and New Jersey in two important areas. First, we are in the business of moving goods and people internationally. We naturally want to see our markets expand, not contract. Second, our health as a business is dependent on the economic health of our region and its businesses — importers, exporters and financial institutions.

In discussing the impact to date of this situation on our operations, it is helpful to look at three distinct economic periods in Latin America: the high growth years, essentially the 60's and 70's; the recession years, 1982 and 1983; and the recovery since. After almost 20 years of uninterrupted high growth, real Gross Domestic Product (GDP) in Latin America fell by 1.4% in 1982 and 2.4% in 1983. The only other region which saw similar contraction in those years was Africa; developing Asia, in contrast, grew by 5.2% in 1982 and 6.3% in 1983. Since then, Latin American economic growth has resumed, but at lower rates than before the recession.

The two recession years for Latin America, of course, coincided with the onset of the debt crisis. In response to externally imposed austerity programs, foreign exchange constraints and the requirements of domestic economic and political reform, Latin America dramatically reduced its imports. U.S. exports to the region, after growing for several years at 20-30% rates, fell 23% in 1982 and almost 30% in 1983.

How did this collapse of what had traditionally been a major U.S. market affect the Port Authority of New York/New Jersey? In 1982, exports from our customs district to the eight largest Latin American countries were down 22%. 1983 produced a further 36% decline. By contrast, our total exports were up 2.2% in 1983; although it was not a great year for exports generally (our exports to Italy and France, for example, were down 9%) the truly dramatic collapse was confined to Latin America. Between 1981 and 1983, the value of NY/NJ exports to Mexico declined 78%, to Venezuela 60%, and to Argentina 55%. Our tonnage was down similarly. Between 1981 and 1983, oceanborne cargo from NY/NJ to Brazil dropped over 47% and to Peru, 55%. Similar declines were recorded by Miami and Houston, the U.S. ports with the first and second-highest dollar trade with Latin America. (New York/New Jersey is third.) Given the timing and intensity of these shifts, the debt crisis would seem indeed to have had a major negative impact on both the Port Authority's and the NY/NJ region's exports, even without considering the related impact on our services sector.

The trade barriers that Latin American debtor countries have imposed to hold down imports and preserve foreign exchange for debt payment have also adversely affected the operations of our trade program which provides export assistance to small and medium sized manufacturers. These barriers include measures such as restrictions on the issuance of import licenses, high tariffs, import quotas and outright bans on imports of certain products. Last year our export trading company, XPORT (which won the President's 1986 "E" award for excellence in exporting) made only about one percent of its sales to Latin America.

As Congress has been learning to its sorrow, however, trade statistics are never as simple as they appear at first glance. All these numbers must be qualified for several very important reasons: first, there were other factors strongly affecting our trade flows during this period, among them the dollar's increasing strength against even the Latin American currencies.

Despite the fact that most Latin American currencies are pegged to the dollar, the inflation-adjusted purchasing power of the eight major countries' currencies nonetheless fell markedly in 1983: 27% for Brazil, 20% for the Chilean peso, 8% for the Mexican peso. By 1985, even the strongest of these currencies, the Ecuadorean sucre, had depreciated almost 8% in real terms from its pre-debt average. Thus, while price effects certainly do not explain the whole of our export decline, they clearly account for a great deal of it.

Also, part of the decline in the PA of NY/NJ's Latin American exports is due to competitive shifts among U.S. ports and industrial sectors. In 1981, 20% of the U.S.'s exports to the major economies of Latin America (excluding Mexico) passed through our customs district. By 1985, that share had fallen to 18.4%, with corresponding gains being registered by, for instance, Tampa and Miami. That decline in share could also account for a significant portion of our decline in exports.

Finally, things could have been worse. We have been fortunate in having a mix of trading partners and export commodities which has cushioned us somewhat. Mexico, for example, represents only a small part of our region's export markets. Our largest single Latin American trading partner is Brazil, whose imports from our region in 1985 had recovered to only 1% below their 1981 level, in contrast to the sharply lower levels of the other major countries. (Of course, the fact that 50% of our Latin American exports are to Brazil is somewhat less reassuring to me as the days go by.) Also, the commodities our region tends to sell to these countries are largely manufacturing inputs (paper and paperboard, chemicals, plastics, machinery) rather than agricultural products, which have been hard hit by the shrinkage of one of their major markets.

To summarize, given the triple whammy of debt constraints, currency shifts and market share losses, it is difficult if not impossible to assign a dollar figure to the impact of the debt crisis on our export business. However, we are deeply concerned about the decline, actual and potential, of our region's export markets in Latin America. Without a sustained recovery of growth and investment in those countries it is hard to imagine a significant recovery of our region's markets.

The good news from an importing perspective, however, is that as the crisis deepened, our Latin American trading partners massively increased their exports to our region in order to earn in our markets the dollars they needed to meet their obligations. In 1985, the oceanborne tonnage of Brazilian exports coming into the U.S. through our port jumped by 21%, after an 11% gain in the year before that. Thus, from the point of view of our cargo facilities as well as New York and New Jersey's huge distribution and retail industries, the surge in Latin American imports has meant more business rather than less.

The debt crisis' impact on goods trade, however, is by no means the only issue that concerns us. As I mentioned earlier, half of the major U.S. money center banks with large exposures to Latin American debt are in New York. As the New York Times indicated last week, these outstanding loans now exceed 50% of shareholders' equity for several of the banks. If the present situation deteriorates further, and the stability of our financial sector is impaired, we could see significant negative impacts on our region's job growth and general economic activity.

In conclusion, I should confess that the position of the Port Authority of New York/New Jersey on this issue is that "we have met the special interests and they are us." As exporters, we would like to see a resolution that restores growth and investment to our Latin American trading partners both for the sake of their own stability and welfare and so that they will resume buying our products. As importers, we would like to see a resolution that does not impede or reduce the flow of Latin American products to our producers and consumers. As representatives of a region which depends heavily on the health of the financial services sector, we would like to see a resolution which does not impair the balance sheets of our major banks. In having all these concerns, I believe the Port Authority of NY/NJ fairly represents a microcosm of the competing but legimate interests of not only our region, not only our states, but the country as a whole. I sincerely hope that the Congress and the Administration can design a solution that will satisfy us all.

Thank you for the opportunity to share our views with you today.

STATEMENT OF DR. MARGARET DALY HAYES, DIRECTOR, WASHINGTON COUNCIL OF THE AMERICAS, NEW YORK, NY

Dr. HAYES. Thank you, Mr. Chairman, Senator Rockefeller. The Council of the Americas is pleased to have this opportunity to address the subcommittee on the subject of the impact of the Latin American debt crisis on U.S. businesses operating in Latin America. I am the Director of the Washington office of the Council.

The Council is a business association whose membership includes banks, law firms, accounting firms, comsultancies, manufacturing firms, mining companies, agribusinesses, and others, including Caterpillar. The Latin American economic crisis has had different consequences for each of these types of businesses, and the impact has varied by country, by sector, and by company.

The Council has recently conducted several surveys of its members, who assessed the impact of the Latin American debt crisis on operations in the region and to develop some policy guidance with respect to actions that the U.S. Government or Latin American governments might take to improve the business outlook in the region. I am reporting today on the results of our most recent study, "Coping with Crisis; U.S. Investment in Latin America's Continuing Economic Problems." And Mr. Chairman, I request that the full survey report be included in the record.

Senator BRADLEY. Without objection.

Dr. HAYES. Our 1986 survey drew upon a number of questions from an earlier survey conducted in 1984. The key findings of that survey were: Latin American sales of responding companies had dropped from about 7.5 percent of worldwide sales in 1981 to only 5.2 percent of global sales in 1983. 1984 sales were projected to be only 3.8 percent of global sales. Those declining sales reflected the diminished purchasing power of local markets since most of the multinationals produced primarily for the local markets.

Foreign exchange shortages had caused problems for companies that could not import components necessary to keep production operating. There was a sense of a line at the foreign exchange window with the multinationals not being favored in that line. Trade financing was a serious problem, and 25 percent of the respondents reported having lost U.S. export sales because of lack of trade financing. U.S. parent support of Latin American affiliates increased dramatically between 1982 and 1984.

These findings underscored that in a very real sense what is bad for Latin America is bad for corporations operating there and vice versa. The debt crisis had a profound impact on U.S. companies operating in the region. The worst period was 1982 and 1983. By the middle to end of 1984, companies began to perceive that adjustment had begun to lead to renewed growth prospects. And by the middle of 1986, in spite of difficulties in Mexico and other oil price driven economies, there was a very real sense that the light could be seen at the end of the tunnel. Council members' interest in 1986 was not so much in the debt crisis but how best to promote a return to growth.

The overriding conclusions of that survey were that companies are now coping with the continuing economic crisis; but they are not overly optimistic about the near or mid-term, and they do not have plans for investment of a magnitude to affect near-term or mid-term economic growth in the region.

A pessimistic assessment of the economic climate in most countries remains the chief constraint on corporate forward planning. On the positive side, however, most companies anticipate much better times by the 1990s and 1995 time frame.

In 1986, Latin American sales were about 5.2 percent of global sales, or about the same as in 1983. Sales did not fall to the 3.8 percent projected in mid-1984. Of 285 operations between 1983 and 1986, 27 percent reported contraction, 38 percent reported no change or no growth, and 36 percent reported some—mostly very slight—expansion.

Most of the reporting companies remained somewhat profitable during the 1980s, but nearly one-fourth had been unprofitable since 1981, the year before the crisis had hit most countries. Only a little over half of the responding companies had reported dividend remittances since 1981—including 1981. Foreign exchange was more readily available in 1986 but continued to be a constraint on business at mid-year. Parent companies' financial support to affiliates was at the same or higher levels than 1982/1983 for 70 percent of the cases.

Thus, the macroeconomic situation in Latin America continues to have an important impact on U.S. affiliate operations. Domestic economic performance is not everything, however. As Latin American countries began to pull out of their slump beginning in 1984, other factors came into play that also affect investment. These include the frequently onerous rules of the game imposed on foreign investors and the increasingly less competitive position of Latin American products on the world market.

We asked a number of questions about this business environment. Of 11 world regions, only Africa, India, Eastern Europe, and the People's Republic of China ranked below Latin America in terms of business climate. Brazil was regarded as the best place to do business in Latin America, but Brazil is also perceived to be a very difficult place to do business. A majority of companies perceived that the written rules of the game were generally neutral toward foreign investments but applied arbitrarily or unfairly.

U.S. investment is turning increasingly to other markets, especially the U.S. itself and the Far East. Beginning in 1983—admittedly a poor year for Latin America—flows of new overseas U.S. foreign investment to the Far East surpassed flows to Latin America for the first time. That trend continues and has a profound and largely unforeseen impact on Latin America's own long-term growth potential.

The debt crisis has assured that Latin American countries focus on structural impediments to growth in their countries. These reforms have a potentially profound impact on the economic and business environment in Latin American countries. Foreign investors and domestic investors who have taken their capital abroad may find the region more attractive if bureaucratic procedures are streamlined and private investors are permitted greater freedom to operate and if the public sector wavers, the overall economy is diminished.

However, there are serious doubts as to whether governments have the political will or are strong enough to implement changes that will inevitably have consequences for vested interests in their country. Thank you, Mr. Chairman.

Senator **Bradley**. Dr. Hayes, thank you very much.

[The prepared written statement of Dr. Hayes follows:]

THE IMPACT OF THE LATIN AMERICAN DEBT CRISIS ON U.S. CORPORATIONS OPERATING IN LATIN AMERICA

Testimony by
Dr. Margaret Daly Hayes
Director, Washington Office
Council of the Americas

before the
Subcommittee on International Debt
Committee on Finance
United States Senate

March 9, 1987

Mr. Chairman, Members of the Subcommittee, I am Margaret Daly Hayes, Director of the Washington Office of the Council of the Americas. I am pleased to have received your invitation to address this Committee on behalf of the Council, a business association of some 200 U.S. corporations with interests in Latin America and the Caribbean.

The Council's membership is diverse. It includes banks, law firms, accounting firms, consultancies, manufacturing firms, mining companies, agribusinesses and others. The Latin American economic crisis has had different consequences for each of these types of businesses. The impact has varied by country, by sector and by company.

Because of the diversity of interests of its membership, the Council does not often take positions on policy questions. The Council's purpose is to encourage sharing of information between U.S. and Latin American governments and private sector representatives to enhance the understanding and acceptance of the role that U.S. private enterprise plays in the region's economic development.

To develop such information the Council has recently conducted several surveys of its members, first, to assess the impact of the Latin American debt crisis on U.S. corporate operations in the region and second, to develop some policy guidance with respect to those activities that the U.S. government or Latin American governments might take to improve the business outlook in the region. I am reporting today on the results of the Council's most recent study, **Coping with Crisis: U.S. Investment and Latin America's Continuing Economic Problems**. This survey was conducted in the summer and early fall of 1986 and published last month. With your permission, Mr. Chairman, I submit the full survey report for inclusion in the record.

Before reviewing the data generated by this survey, let me provide a general framework for the presentation. For companies operating in Latin America, the debt crisis to date can be divided into three periods: the period of crisis - 1982 to approximately 1983 when the severest austerity measures were implemented; 1984-1985, a period of gradual adjustment when some economies began to grow again, and 1986, when, except for the oil exporting economies, growth seemed more assured.

The Council conducted a survey of its members in both 1983 and 1984 to assess the impact of the first and second periods. The 1986 survey focuses on the second and third periods.

It is useful to review the findings of the 1984 survey to appreciate the evolution of perceptions about the business climate in Latin America. The survey reported the responses of 52 major U.S. companies with about 150 operations in the four major Latin American economies, Mexico, Brazil, Argentina, and Venezuela.

Economically, 1984 was an interesting year for Latin America. Adjustments undertaken in 1982 and 1983, the nadir of the debt "crisis" for most of the countries, began to pay off, and some of the economies began to stabilize. Brazil grew at 4.5 percent in 1984, Mexico at 3.7 percent. By the end of the year, many people believed that the crisis was over and the difficult road to recovery had been found.

Perhaps the most important finding of the 1984 Council survey was that over the debt crisis period (1982-1984) Latin American sales of the responding companies had dropped from about 7.5 percent of world-wide sales in 1981 to only 5.2 percent of global sales in 1983. Sales for 1984 were projected to be only 3.8 percent of global sales. Corporate members observed that when an operation's sales fall below five percent of corporate total, that segment of the company "disappears from the view" of top management. Members worried in 1984 that even if Latin America began to grow robustly, it would be difficult to draw corporate financial and human resources back into the region.

The 1984 survey revealed a number of other interesting facts.

> (1) Declining sales reflected the diminished purchasing power of the local markets since most of the multinationals produced primarily for the local market;
>
> (2) Foreign exchange shortages had caused some problems for the companies that could not import components necessary to keep production operating. There was a sense of a line at the foreign exchange window in a number of countries, and, with severely limited foreign exchange, only the banks were being paid. Nevertheless, by mid 1984, the foreign exchange access problem was perceived to be diminishing,

especially in Mexico and Brazil.

(3) Trade financing was a problem and 25 percent of the respondents reported having lost U.S. export sales because of lack of trade financing, unacceptable financing cost or unwillingness to assume the risk of unsecured trade credit transactions. Nevertheless, 1984 reporting suggested an improvement in trade financing over 1983. Most companies had shifted to secured financing for third parties.

(4) U.S. parent support of Latin American affiliates had of necessity increased dramatically between 1982 and 1984. Parents finance (self-finance) their affiliates through hard currency loans from the parent, intercompany account build-up, forbearance in dividend and other remittances, back to back loans, parent company bank guarantees and other types of intercompany debt. The 1984 survey suggested that parent company financing had increased substantially and that some companies believed that parent willingness to continue to support affiliates in Latin America was near or at an end.

I go through this because in a very real sense, what is bad for Latin America is bad for corporations operating there, and vice versa. The debt crisis did have a profound impact on U.S. companies operating in the region. The worst period was in the 1982-1983 time frame, and by the middle to end of 1984, many companies began to perceive that adjustment had begun to lead to renewed growth prospects.

By mid 1986, in spite of difficulties in Mexico and other oil-price driven economies, there was a very real sense that the light could be seen at the end of the tunnel. The Council's interest in 1986 was not so much on the debt crisis, but rather on how best to promote renewed growth in the region.

The Council's 1986 survey reported responses by 50 corporations with 285 operations in 12 Latin America countries -- the four major economies reported on previously, other Andean countries and Central America. The overarching conclusion reached by the Council's survey task team was that companies appear to be coping with the continuing economic crisis in Latin America, but are not overly optimistic about the near- or mid-term. They do not have plans for investment of sufficient magnitude to affect near-term economic growth in the region, and a continuing pessimistic assessment of the economic climate in most countries remains the key constraint on corporate planning. Most companies anticipated much better times by the 1990-1995 time frame.

In 1986, Latin American sales were about 5.2 percent of global sales, about the same as in 1984. Of 285 operations, 38 percent of the companies reported "no change" in operation size between 1983 and 1986 (when growth resumed in several countries); 37 percent reported some, mostly slight, expansion, and 28 percent reported contraction of operations. Looking ahead to the next 24 months, few companies see prospects for change. Most of the reporting companies had remained somewhat profitable during the 1980s, but nearly one-fourth had been unprofitable since 1981 (the year before the debt crisis hit most countries). In Mexico, Ecuador and Peru, over half of respondents showed profitability declining. Only a little over half of responding companies had reported dividend remittances since 1981.

Foreign exchange was more readily available, but continued to be a constraint on business at mid-year 1986. In this regard, it is interesting to note that a recent Bank of Boston newsletter from Brazil noted that lines are beginning to form at the foreign exchange window in Brazil during the final quarter of 1986. Parent company financial support to Latin American affiliates is at the same or higher levels than 1982/83 for 70 percent of the cases reporting.

All of the Council's surveys indicate that the macro-economic situation in Latin America has had and continues to have an important impact on affiliate operations there. Most U.S. corporations went into Latin America a long time ago - many in the early part of this century - in order to take advantage of what was then the most "developed" and "sophisticated" developing world region. During the heyday of import substituting industrialization they became more involved under the special rules of the game that Latin American governments offered to attract investors and promote production for the domestic economy. Domestic economic performance has a fundamental impact on the corporate bottom line.

Nevertheless, domestic economic performance is not everything. As Latin American countries began to pull out of their 1982/83 slump, other factors came into play that also affect U.S. investment in Latin America. These other factors include the frequently onerous "rules of the game" imposed on foreign investors by Latin American governments, and the increasingly less competitive position of Latin American products on the world market.

We sought to tap these dimensions of the problem in the 1986 survey and asked a number of questions about the "business environment," i.e., the operating environment in which the foreign investor must do business. Among world regions, only Africa, India, Eastern Europe and the People's Republic of China ranked below Latin America in terms of business environment. Brazil was regarded as the "best" place to do business in Latin America, but overall, Brazil is also perceived to be a very difficult place to do business.

Interestingly, a majority of companies perceived the written rules of the game to be generally neutral toward foreign investment. However, they are believed to be applied arbitrarily or unfairly in Mexico and Peru and to a certain extent in Brazil and Argentina. Companies are generally in agreement that they can operate successfully in a given economic or regulatory environment, in spite of negative rules, as long as the rules are not constantly changing. Latin American countries' arbitrariness in applications of rules represents a major cost to companies and ultimately to Latin American economies. In another Council survey of members operating in the Andean environment, this point was made even more explicitly.

What does this all mean? Resolving the debt situation alone is not likely to prove a panacea for Latin America's problems, nor is U.S. investment likely to flock there once the uncertainty of the economic situation has passed. U.S. investment is turning increasingly to other markets, especially the United States itself and the Far East. Beginning in 1983, admittedly a poor year for Latin America, flows of new U.S. overseas foreign direct investment to the Far East surpassed flows of new investment to Latin America for the first time. New investment flows to the Far East have continued to increase, despite Latin America's pick up beginning in 1984. In the near and mid-term, it is not likely that this shift of investment interest away from Latin America and to the Far East will change. This has profound implications for Latin America's own long term growth potential. Issues such as market reserve, lack of intellectual property protection, price controls, inadequate quality control, lack of competitiveness in the world market, high costs of domestic inputs, and arbitrariness in application of the rules all motivate investors -- and not just U.S. investors -- to look elsewhere before deciding to invest in Latin America.

The situation is improving in Latin America. The debt crisis has assured that countries in the region begin to focus on the structural impediments to growth in their countries. These reforms have a potentially profound impact on the economic and business environment in Latin American countries. Both foreign investors and domestic investors who have taken their capital abroad may find the region more attractive if bureaucratic procedures are streamlined, private investors are permitted greater freedom, and if the public sector weight in the overall economy is diminished. These are reforms that are entailed in the policy lending that is currently being implemented in the region. The 1986 survey, however, reveals little evidence that companies see these reforms taking place yet.

Latin American countries have a very long way to go, however. In spite of very encouraging language about reforms, there are underlying doubts as to whether governments have the political will or are strong enough to implement desired changes that will inevitably have consequences for vested interests in that country. Investors also ask, "will the next administration change everything back?" It will take a long time for those doubts to be dispelled.

In concluding, then, the Council's survey reveals that the economic crisis in Latin America has had an impact on U.S. companies operating there. They are not growing at the rate they would otherwise expect to grow, and they are not likely to grow until the domestic economies pick up. Debt relief on the modest scale that most discuss is not likely to promote domestic economic growth of sufficient magnitude to improve dramatically the position of U.S. corporations operating in Latin America. Equally or more importantly, however, many, if not most, companies are not disposed to make new investments in Latin America because the region does not yet offer an attractive and competitive investment climate. Many companies do not export from Latin America because the products they can produce under current operating rules are not competitive in the world market place. The structural reforms being insisted upon by the World Bank, the administration, and others must be undertaken to improve the region's general competitiveness.

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COUNCIL OF THE AMERICAS
1986 MEMBERSHIP SURVEY

COPING WITH CRISIS:
U.S. INVESTMENT AND LATIN AMERICA'S CONTINUING ECONOMIC PROBLEMS
A Council of the Americas Survey of Company Operations, Policy Reforms and Investment Prospects in Twelve Latin American Countries

Part I. Introduction

The Council of the Americas is a business association of approximately 190 U.S. companies with interests in Latin America and the Caribbean. Since its founding in 1958, the Council has earned a reputation as the most credible U.S. private sector organization reflecting international business interests in Latin America. The Council's activities bring its corporate member executives together with Latin American and U.S. government officials and with members of the Latin American private sector to enhance the understanding and acceptance of the role that U.S. private enterprise plays in Latin America's economic development.

Council of the Americas member corporations are engaged in a variety of activities in Latin America, including agribusiness, extractive operations and industry, manufacturing, sales and product service, service (eg., accounting, consulting and insurance), banking and other activities. About 15 percent of the membership operates in each sector, with a slightly higher representation in sales and product service and manufacturing.

Background and Universe of Council Surveys

To provide information on the impact of the Latin American debt crisis on U.S. business operations in the region, the Council conducted surveys of its membership in 1983 and 1984. Those surveys reported the impact of the debt crisis on member operations in Argentina, Brazil, Mexico and Venezuela. In 1983, at the request of the Bipartisan National Commission on Central America, the Council conducted a survey of its members operating in Central America. In January 1986, the Council conducted a limited survey of its members operating in the Andean countries.

The present survey goes beyond previous surveys to assess not only the impact of the continuing economic crisis in Latin America on member operations, but also to explore attitudes toward and the impact of policy reforms being undertaken and proposed for the region. In addition, this survey asked member companies to report on their activities in each of 12 Latin American countries, the four major economies -- Argentina, Brazil, Mexico and Venezuela --, four Andean countries -- Colombia, Ecuador, Peru and Chile --, and four Central American countries -- Guatemala, El Salvador, Honduras and Costa Rica.

The 1986 survey was administered shortly after mid-year 1986 to all non-bank Council members, or approximately 150 companies. The Council received responses from 50 members who reported on over 300 operations (See Table 3) and over 500 sector involvements (See Table 2) in the twelve countries. The responses represent a slight bias in favor of Council members operating in the "manufacturing" and "sales and product service" areas in Latin America. A number of members, especially those in the service and miscellaneous categories (about 20 percent of Council membership) declined to respond because their operations were conducted entirely out of the United States.
For the most part, the survey questionnaire was completed by principal officers of Latin American operations operating out of corporate headquarters. Their responses were received and compiled by the independent accounting firm, Arthur Andersen & Co. which holds the identity of the respondents confidential. The Council is grateful for Arthur Andersen & Co.'s continuing support for its survey efforts.

Seven Council member executives served on the Survey Task Team reviewing the questions and assessing the responses. This report reflects the Survey Task Team's interpretation of the responses from the member companies.

Quantitative data in this report are current as of mid-1986 with estimates for year-end 1986 and future performance. Not all companies answered all questions and the number of operations reporting is not constant over the period surveyed. Respondents to the equipment sales, etc.) and in Manufacturing. Agribusiness, Extractive and Service Industry (eg., engineering, consulting, accounting and legal services) representation is less strong. Manufacturing and Sales and Product Service represent about 20 percent of the survey universe and 30 percent of the survey responses. Banks and financial intermediaries were not included in the survey.

The percentage distribution of activities among countries should be noted. In three of the four major economies -- Argentina, Mexico and Venezuela -- about one-third of total reporting company operations are in Sales and Product Service and, in Argentina and Venezuela, one-third of operations are also in Manufacturing. In Mexico and Brazil, the manufacturing share of activities is 40 percent. With the exception of Colombia and Guatemala, over 50 percent of the reported operations are in Sales and Product Service in all of the other countries.

TABLE 2
MAJOR SECTORS OF OPERATION OF REPORTING COMPANIES
Percentage Figures
(Number of Companies Reporting in Parentheses)

	Argentina	Brazil	Mexico	Venez'la	Chile	Colombia	Ecuador	Peru	CostaR	El Sal	Guat'la	Honduras
Agribusiness	14 (8)	15 (10)	13 (8)	15 (8)	7 (3)	13 (6)	5 (2)	10 (4)	10 (3)	9 (2)	16 (5)	18 (4)
Extractive	11 (6)	7 (5)	6 (4)	5 (3)	7 (3)	11 (5)	8 (3)	13 (5)	3 (1)	-	6 (2)	-
Manufacturing	32 (18)	41 (28)	41 (26)	35 (19)	23 (10)	29 (13)	17 (7)	10 (4)	21 (6)	23 (5)	22 (7)	18 (4)
Sales and Product Service	33 (19)	28 (19)	33 (21)	38 (21)	49 (21)	36 (16)	57 (23)	55 (22)	59 (17)	68 (15)	47 (15)	59 (13)
Service Industry	7 (4)	6 (4)	6 (4)	5 (3)	9 (4)	9 (4)	8 (3)	10 (4)	3 (1)	-	9 (3)	4 (1)
Other	3 (2)	3 (2)	2 (1)	2 (1)	5 (2)	2 (1)	5 (2)	2 (1)	3 (1)	-	-	-
Number of Operations	57	68	64	55	43	45	40	40	29	22	32	22

Structure of Equity Investment

Companies were asked to indicate whether they had equity investment in the countries, its age, and the nature of its ownership. The responses reported in Table 3 indicate that the strong majority of reporting companies had equity investment in the various countries and, in more than half of the cases, the initial investment was made prior to 1960. A high proportion of the reported equity investment is 100% U.S.-owned. Mexico is a singular exception to this pattern with 51 percent of respondents reporting 100 percent U.S. ownership and 37 percent
reporting minority U.S. owned joint ventures. Members of the Survey Task Team observed that the pattern in Mexico is a reflections of variations in Mexico's foreign investment rules.

TABLE 3
STRUCTURE OF EQUITY INVESTMENT IN LATIN AMERICA

	Argentina	Brazil	Mexico	Venez'la	Chile	Colombia	Ecuador	Peru	CostaR	El Sal	Guat'la	Honduras
Number of Operations Reporting	36	42	39	37	32	31	27	29	22	20	23	21
Number with Equity Investment	29	39	35	27	20	23	16	17	10	6	13	8
Initial Investment Made Prior to 1960	25	25	27	21	6	14	5	9	2	3	4	4
Equity Investment is												
100% U.S.-owned (%)	24(83)	33(85)	18(51)	19(70)	16(80)	18(78)	12(75)	12(71)	10(<100)	4(66)	13(<100)	7 (87)
Majority U.S.-owned	3	2	4	4	4	2	2	4	1	1	0	1
Minority U.S.-owned	2	4	13	5	1	6	1	2	-	1	1	1

PART II. IMPACT OF THE CONTINUING ECONOMIC CRISIS ON OPERATIONS

Expansion and Contraction of Operations Since 1983

Companies were asked to report how their operations had changed overall in each country since 1983, a low point in Latin American economic performance because of the 1981-82 global recession and the deepening impact of the debt crisis. Table 4 indicates that between 1983 and 1986, operations grew only slightly more than they shrank (a ratio of about 5:4). Nine operations closed down, while eight opened (four in Central America, three in Ecuador and one in Brazil).

TABLE 4
EXPANSIONS, CUTBACKS AND CLOSING OF OPERATIONS IN LATIN AMERICA
(Number of Companies Responding)

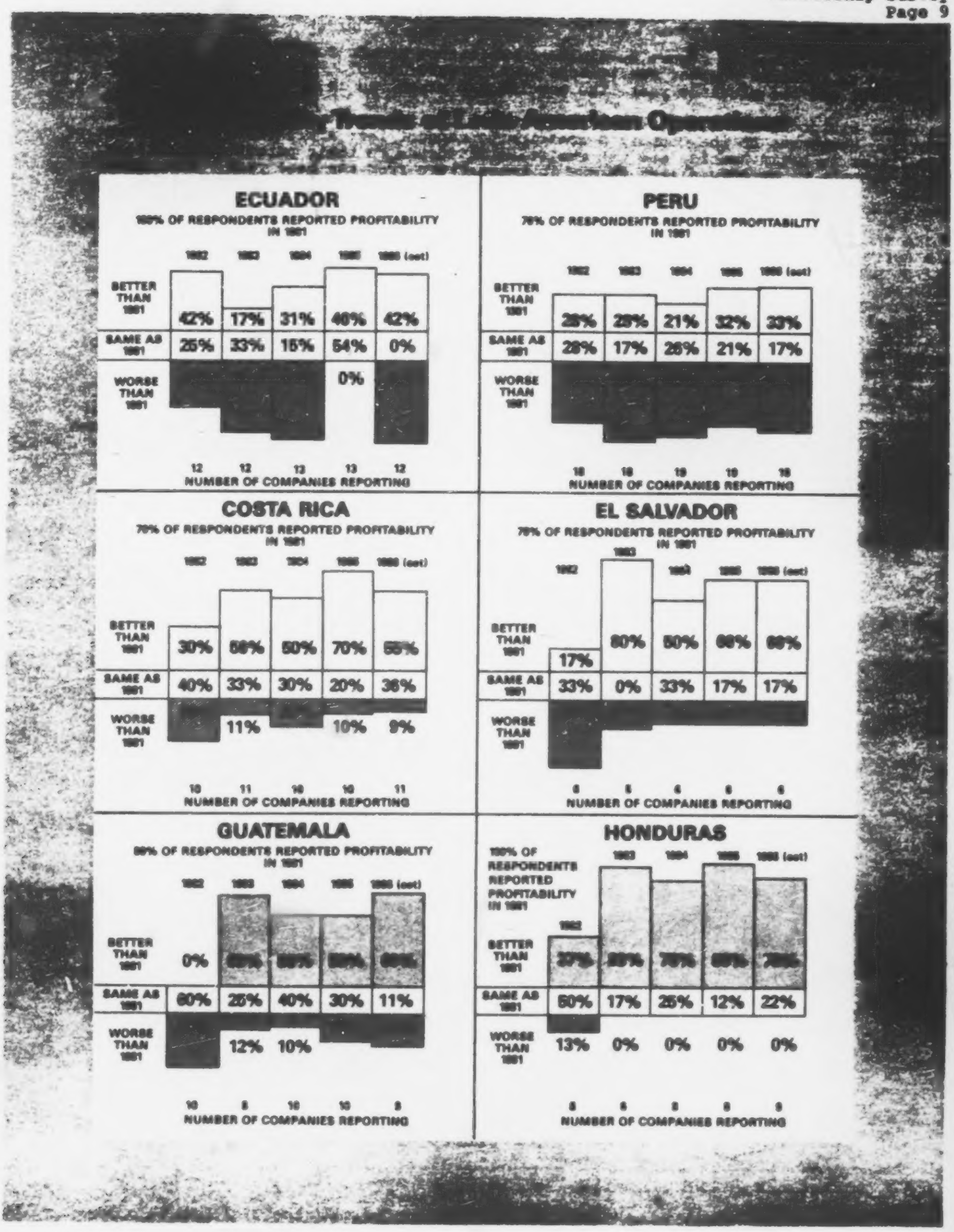
	Argentina	Brazil	Mexico	Venez'la	Chile	Colombia	Ecuador	Peru	CostaR	El Sal	Guat'la	Honduras
Opened or Expanded Operations	13	23	20	6	10	10	6	4	5	1	5	4
No Change in Operations	9	9	9	14	8	12	12	9	11	6	12	8
Cut Back or Closed Down	13	10	11	12	5	7	6	12	1	1	3	0
Number of Companies	35	42	40	32	13	29	24	25	17	8	20	12

The questionnaire asked respondents whether they expanded or cut back operations "a lot" or "a little". Table 4 aggregates "openings" and "expansions" into a single category and "close downs" and "cut Backs" into another. The vast majority of companies reporting expansions indicated that they had expanded "a little." A majority (57 percent) of respondents reporting "cut backs" indicated that they cut back "a little," but 43 percent reported cutting back "a lot". Examination of the raw data reveals that 41 operations cut back a little while 80 expanded a little; 31 cut back a lot and 19 expanded a lot. At the same time, and more importantly, perhaps, respondents reported that 109 operations, or 38 percent of operations reporting, remained unchanged over the four year period. The Survey Task Team noted that since the base year (1983) was a negative one, the "no change" response was worrisome. Despite overall improvement in Latin American economic performance since 1983, multinational corporations (MNC) operations have not seen improvements.

Companies reported that "improving local market demand" and "normal growth of business" were the principal reasons for expansions. In Brazil "new product success" was a frequent response. Lower production costs were mentioned as a reason for opening or expanding in Brazil and Mexico, and "improved political stability" was mentioned by several respondents for Brazil. "Local economic recession" and "depressed product demand" were mentioned as reasons for cutting back or closing down. "Political instability" was raised in the case of Peru as a reason for cutting back.

The Survey Task Team noted that, as would be expected in a sluggish economy, macroeconomic factors dominated the responses while issues like performance requirements were mentioned less frequently and only in Brazil, Mexico and Venezuela. The Task Team also observed that the "little" changes in operations may be attributable to reinvestment of local currencies, or bottle necks in operations, as well as normal response to recovery in the case of "little" expansions. The Task Team also emphasized that the majority of operations reported "no change". Since business in 1983 was not good for most companies, "no change" represents a continuation of relatively bleak performance. Most operations do not appear to have improved their situations. Argentina, Brazil and Mexico all report expansions about equal to "no change" and "cut back" responses. Central American countries by and large report "no change."

The Survey Task Team observed that the picture emerging from the data is not particularly encouraging. On the one hand, the Task Team recalled that operations in Latin America evidenced "profit difficulties" well before the impact of the debt crisis. Situations in which 20 to 25 percent of operations do not show a profit are not likely to be encouraging to new investors. Moreover, the reporting of profitability or lack of profitability does not speak to the question of magnitude of profits. Members of the Survey Task Team observed that local affiliates seek to remain profitable and will make adjustments in operations to accomplish this. Those adjustments may include reducing operations. At the same time, with a few exceptions -- Mexico, Ecuador, Peru -- the pattern of profitability seems to be evolving in a positive direction, with an increasing percentage of companies responding that profitability is improving over time.


Trends of Latin American Operations
ECUADOR
100% OF RESPONDENTS REPORTED PROFITABILITY IN 1981
BETTER THAN 1981
42%
17%
31%
46%
42%
SAME AS 1981
25%
33%
15%
54%
0%
WORSE THAN 1981
0%
12
12
13
13
12
NUMBER OF COMPANIES REPORTING
PERU
79% OF RESPONDENTS REPORTED PROFITABILITY IN 1981
BETTER THAN 1981
26%
28%
21%
32%
33%
SAME AS 1981
28%
17%
26%
21%
17%
WORSE THAN 1981
NUMBER OF COMPANIES REPORTING
COSTA RICA
70% OF RESPONDENTS REPORTED PROFITABILITY IN 1981
BETTER THAN 1981
30%
56%
50%
70%
55%
SAME AS 1981
40%
33%
30%
20%
36%
WORSE THAN 1981
11%
10%
9%
10
11
10
10
11
NUMBER OF COMPANIES REPORTING
EL SALVADOR
79% OF RESPONDENTS REPORTED PROFITABILITY IN 1981
BETTER THAN 1981
17%
80%
50%
66%
66%
SAME AS 1981
33%
0%
33%
17%
17%
WORSE THAN 1981
NUMBER OF COMPANIES REPORTING
GUATEMALA
OF RESPONDENTS REPORTED PROFITABILITY IN 1981
BETTER THAN 1981
0%
SAME AS 1981
60%
25%
40%
30%
11%
WORSE THAN 1981
12%
10%
10
10
10
NUMBER OF COMPANIES REPORTING
HONDURAS
100% OF RESPONDENTS REPORTED PROFITABILITY IN 1981
BETTER THAN 1981
37%
83%
75%
88%
78%
SAME AS 1981
50%
17%
25%
12%
22%
WORSE THAN 1981
13%
0%
0%
0%
0%
NUMBER OF COMPANIES REPORTING

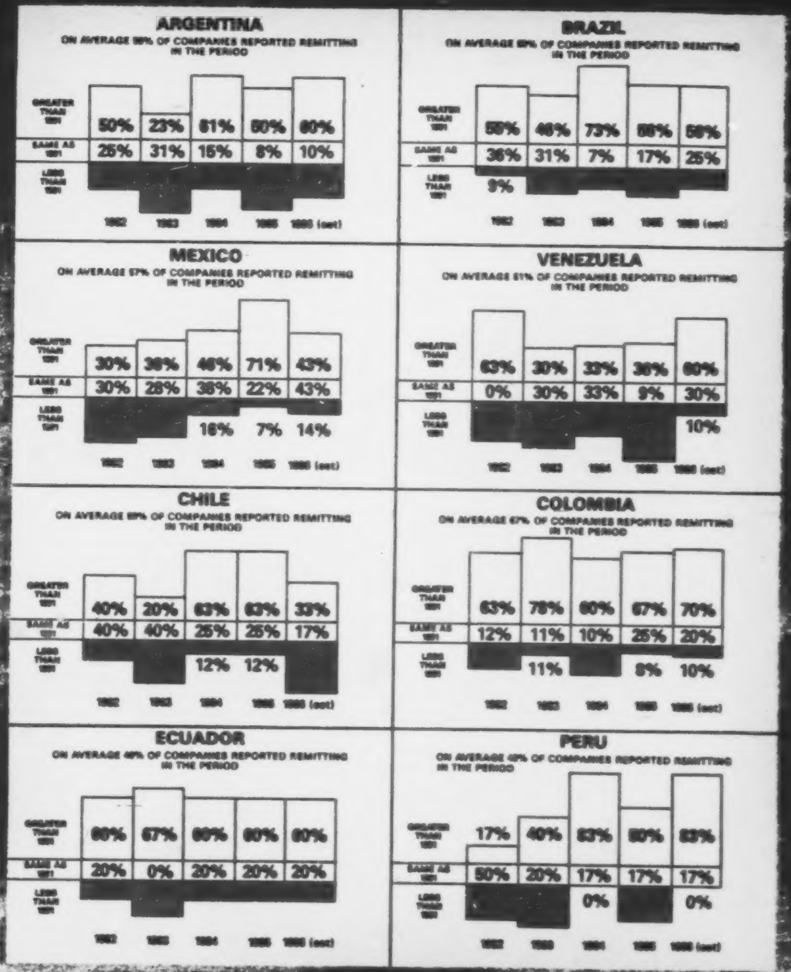

ARGENTINA
ON AVERAGE OF COMPANIES REPORTED REMITTING IN THE PERIOD
GREATER THAN 1981
SAME AS 1981
LESS THAN 1981
50% 23% 61% 60% 60%
25% 31% 15% 8% 10%
1982 1983 1984 1985 1986 (est)
BRAZIL
55% 46% 73% 68% 58%
36% 31% 7% 17% 25%
9%
MEXICO
30% 36% 46% 71% 43%
30% 28% 38% 22% 43%
16% 7% 14%
VENEZUELA
63% 30% 33% 36% 60%
0% 30% 33% 9% 30%
10%
CHILE
40% 20% 63% 63% 33%
40% 40% 25% 25% 17%
12% 12%
COLOMBIA
63% 78% 60% 67% 70%
12% 11% 10% 25% 20%
11% 8% 10%
ECUADOR
60% 67% 60% 60% 60%
20% 0% 20% 20% 20%
PERU
17% 40% 83% 60% 83%
50% 20% 17% 17% 17%
0% 0%

TABLE 7
LATIN AMERICAN AFFILIATES' REQUIREMENTS FOR PARENT FINANCIAL SUPPORT
(number of companies reporting)

	Argentina	Brazil	Mexico	Venez'la	Chile	Colombia	Ecuador	Peru	CostaR	El Sal	Guat'la	Honduras
Up a little/a lot	8	13	10	10	2	6	4	5	2	0	2	0
The Same as 1982/1983	12	14	10	7	9	8	7	5	6	3	7	5
Down a little/a lot	8	10	9	7	6	7	4	7	3	1	4	2

TABLE 8
PARENT WILLINGNESS TO CONTINUE FINANCING TO LATIN AMERICAN AFFILIATES
(number of companies reporting)

	Argentina	Brazil	Mexico	Venez'la	Chile	Colombia	Ecuador	Peru	CostaR	El Sal	Guat'la	Honduras
Willing to Continue Financing	13	25	15	12	12	12	9	9	6	2	8	5
Willing, but could Reach a Limit in Next 24 Months	4	2	7	2	-	3	-	-	1	-	1	-
Not Willing. Reached the Limit before 1985.	8	4	6	6	4	3	3	3	3	1	2	2
Not Willing. Reached the Limit after 1984.	0	2	3	2	1	2	2	4	1	1	2	1

Of a total of 214 reports, 128 or 60 percent indicated parent company willingness to continue to provide financial support to affiliate operations in Latin America. Of the balance, 20 say they expect to reach a limit of willingness within the next 24 months; 45 reached their limit before 1985, and 21 reached their limit in 1985 or 1986 (after 1984).

Responses to this question seemed to contradict tendencies reported in the 1984 Council survey. The Survey Task Team noted that this is a sign of continued but limited willingness to support operations in Latin America. Overseas affiliates are generally regarded as an integral part of the company. Moreover, the Survey Task Team observed that the economic situations in a number of countries, Brazil, Colombia, and Argentina, for example, look much better today than might have been expected in 1984. That could encourage parent companies to continue support. Those companies that have supported their affiliates to date are not likely to withdraw support at this point. At the same time, that there is an unwillingness to further finance 40 percent of the reported operations is a sign of serious constraint. Moreover, where there is further willingness, there is presumably added cost. In either case, the continued high degree of parent company financing would be a discouraging or dampening factor when further investment is considered.

Dollar versus Local Currency Loans

In 1984 the Council asked about the distribution of affiliates' hard currency borrowing between parent corporations and banks, and the extent to which affiliate debts were overdue. The 1984 Survey indicated a high proportion of borrowing from parents rather than from traditional bank resources. Loans to parents were largely overdue while bank debts were being paid promptly. The question was phrased differently in 1986. The survey asked the proportion of dollar loans owed to parent, banks and others, and whether the parent had guaranteed the bank loan or not.

Responses presented in Table 9 reflect the number of companies reporting the percentage share of their affiliates' dollar loan portfolios are owed to parents, banks and others. The Average Percent Value figures represent the average percentage of all companies' portfolios owed to each type of creditor. For example, in Argentina, 5 companies report that between 61 and 100 percent of the affiliates' dollar loans are owed to parents. The average percentage of all loans owed to parents in Argentina is 77 percent. The percentage figures are not intended to add to 100 percent.

TABLE 10
PATTERNS OF TRADE FINANCING WITH AFFILIATES AND NON-AFFILIATES IN 1986
(Number of companies reporting)

	Argentina	Brazil	Mexico	Venez'la	Chile	Colombia	Ecuador	Peru	CostaR	El Sal	Guat'la	Honduras
Trade Financing with Affiliates												
Same as Pre-Crisis	14	23	19	18	12	13	9	12	6	-	8	7
Partially Returned to Pre-Crisis	3	2	3	2	1	2	1	-	2	5	-	1
Still Shifted to Secured	6	4	5	4	2	2	4	4	2	-	3	-
Trade Financing with Non-Affiliates												
Same as Pre-Crisis	4	6	3	4	5	9	6	3	4	3	3	3
Partially Returned to Pre-Crisis	4	5	4	2	4	4	3	2	3	3	2	2
Still Shifted to Secured	7	4	7	7	6	3	6	12	6	5	8	7

The Survey Task Team noted that the data reflect changed circumstances in Latin America and the motivations to get secured financing for trade with affiliates has disappeared in large part. In the past shifting to secured transactions was one way of exercising leverage over governments to obtain foreign exchange. In the early crisis years, banks were being paid, but equity investors were denied access to foreign exchange. Therefore, bank debt was preferred in the years of the previous survey and secured transactions qualified as such.

Local versus Export Production

A number of policy analysts have expressed the desire that invested multinationals make greater use of existing facilities to expand the export base of countries in which they operate. Council member companies were asked to describe the percentage of their local production that was destined for export in pre-crisis years and presently. Companies were also asked to explain why they shifted production orientation if they had done so.

The data reported in Table 11 suggest that production for export is only a small portion of total production for the reporting companies in the countries surveyed. A nominal shift toward greater production for export has taken place over the last five years.

TABLE 11
LOCAL VS EXPORT PRODUCTION ORIENTATION; PRE-CRISIS AND PRESENT
(Number of Companies Responding)

	Argentina	Brazil	Mexico	Venez'la	Chile	Colombia	Ecuador	Peru	CostaR	El Sal	Guat'la	Honduras
Production for Local Market												
Pre-crisis												
0-20%	1	1	–	-	-	-	1	-	-	-	1	-
21-80%	5	6	7	2	2	1	1	1	1	-	1	2
81-100%	16	24	24	16	9	12	6	8	3	2	5	3
Present-day												
0-20%	-	1	1	-	-	1	1	1	-	-	-	-
21-80%	5	13	10	2	2	2	1	1	2	-	1	2
80-100%	17	20	19	17	9	11	6	6	3	3	6	3
Production for Export												
Pre-crisis												
0-20%	11	12	9	1	-	1	1	-	-	2	-	-
21-80%	2	8	4	1	2	1	1	1	2	--	2	2
81-100%	-	1	2	-	-	1	-	1	1	-	1	1
Present-day												
0-20%	12	17	12	4	1	5	1	1	1	-	3	-
21-80%	-	7	7	2	2	2	1	1	2	-	1	2
81-100%	-	1	2	-	-	2	-	1	1	-	1	1

The majority of companies responding to the survey produced for the local market in the past and continue to do so at present. Moreover, relatively few companies produce primarily (over 80 percent) for export. Most of the responding companies that have shifted some production to export have done so with a modest share of their total

Part III. The Economic and Business Environment in Latin America and Rules of the Game

The results of earlier Council surveys emphasized that the deteriorated economic situation in the region had had a decisive impact on U.S. companies' operations. The region began to recover slightly in late 1984 and in 1985, however, and the Council was interested in assessing the impact of that growth on member operations. In addition, recent debate on economic growth models has emphasized the effect of the business environment and the rules of the game on attitudes toward investment sites. While Latin America experienced overall negative growth in the 1980s, Asia, including Korea, Taiwan, Singapore and other enclave economies experienced a boom. U.S. Department of Commerce data suggest that substantial amounts of new investment is being channeled to Asia at the expense of Latin America today. As a consequence, Latin American governments are being urged to "follow the Asian example" in providing a friendly environment for private investment, both domestic and foreign.

To tap these various issues and to evaluate the likely impact of current policy recommendations on member investors in Latin America, the Council devised a set of questions that would provide insight into member attitudes about the business environment in Latin America. This section describes the results of those questions.

Comparing Investment Climates

Companies were asked to compare the investment climate in Latin America for their business with other areas in which the company operates. Not all companies operate in all of the areas, so the comparisons were specific to each company.

Table 13 shows that Latin America generally is viewed as less attractive for investment than the United States, Canada, the Middle East and the Asia-Pacific region. However the area is considered more attractive than Africa, South Africa, Eastern Europe and, to a lesser degree, the People's Republic of China and the Indian Subcontinent. The comparison with Western Europe was mixed. Thirteen companies reported feeling that Latin America is a better climate than the Western European climate, 18 said it is worse and seven held it about the same.

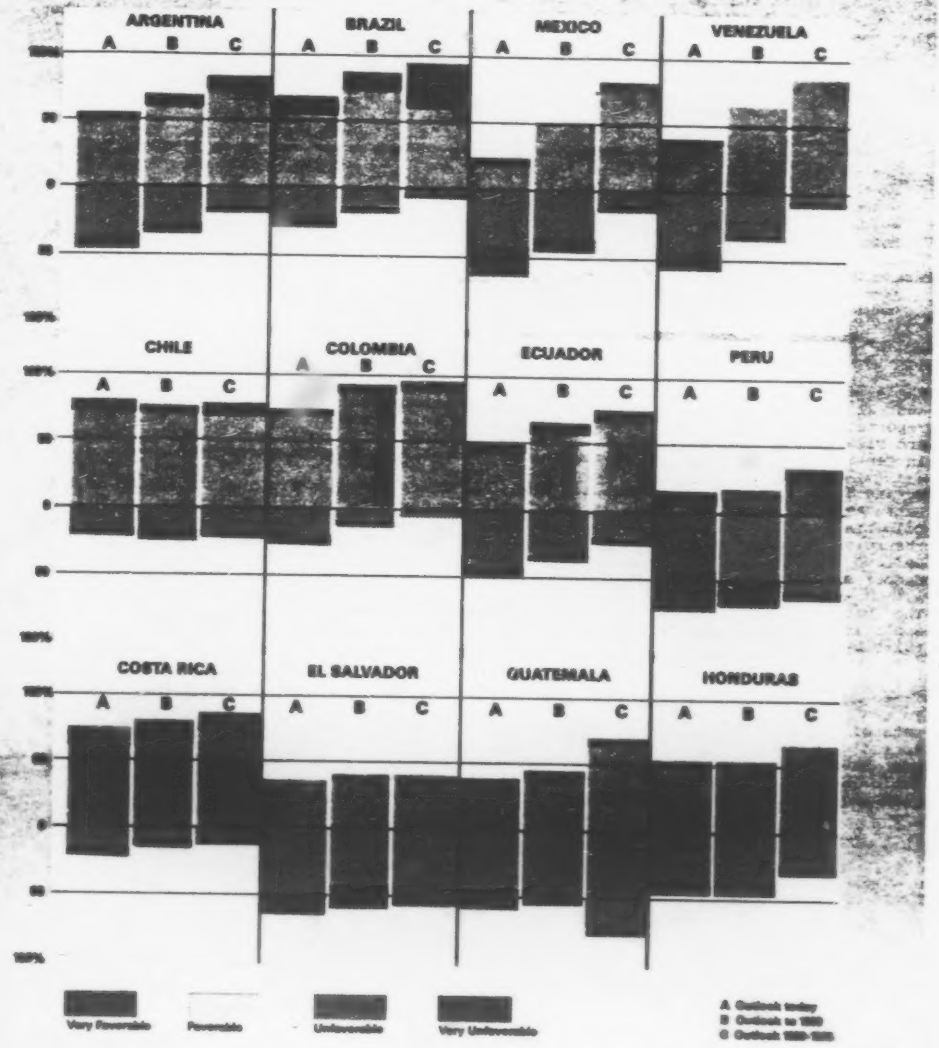
TABLE 13
COMPARISON OF THE LATIN AMERICAN INVESTMENT CLIMATE WITH OTHER WORLD REGIONS
(Number of Companies Responding)

	Latin America is Better Than	Latin America is the Same as	Latin America is Worse Than
United States	2	2	40
Canada	2	3	35
Western Europe	13	7	18
Middle East	5	8	21
Africa	20	8	1
South Africa	25	3	2
East Europe	18	2	1
Asia-Pacific	3	6	29
Peoples' Republic of China	12	5	7
Indian Subcontinent	13	7	5

Companies were also asked to rank Latin American countries in terms of the attractiveness of their investment environment. Brazil was clearly indicated as the Latin American country with the most attractive investment environment, with 31 nominations to first place. Mexico was the second most preferred investment environment with slightly more than half as many nominations as Brazil. Colombia and Argentina ranked next in order of preference by investors.

Figure 3

Outlook for Business Through 1995



"Market reserve", "lack of intellectual property protection", "percent ownership limits" and "technology transfer restrictions" were the key negative trade-related investment rules mentioned. In Table 15, more than half of the companies responding in Brazil, Colombia, Mexico and Peru reported a negative impact from these specific rules. Companies reported little impact from trade-related investment rules in the Central American countries and Ecuador.

TABLE 15
IMPACT OF TRADE-RELATED INVESTMENT RULES ON CORPORATE PLANNING IN LATIN AMERICA*
(Percent respondents reporting that trade-related investment rules "hurt")

	Argentina	Brazil	Mexico	Venez'la	Chile	Colombia	Ecuador	Peru
Market Reservation	32	58	39	25	12	18	17	29
Performance Requirements	24	46	46	40	12	41	23	25
Lack of Intellectual Property Protection	30	58	39	35	25	61	38	53
Percent Ownership Limits	17	27	54	41	12	30	31	39
Technology Transfer Restrictions	21	55	32	38	17	55	43	47
Limits on Expansion	9	20	27	18	6	23	8	29

*An insufficient number of companies reported on Central American countries to yield meaningful statistics.

Impact of the "Rules of the Game" on the Business Environment

Companies were also asked to consider whether foreign investment was receiving different treatment today in Latin America than prior to 1982 and whether that made a difference in corporate planning. The data presented in Table 16 reveal that, by and large, companies feel that there has been no change in the treatment of foreign investment by Latin American countries. One-quarter of respondents for Brazil, 30 percent of respondents for Argentina and 36 percent of respondents for Venezuela report that treatment is worse today than before 1982. Companies reporting for Mexico are almost evenly divided in their assessment that treatment is the same, better or worse. In Chile, Colombia and Ecuador, companies report that treatment is the same or has improved. However, 65 percent of companies report that in Peru treatment is worse today than before 1982. The dominant perception in Central America is that there has been no change in the treatment of foreign investment.

TABLE 16
PERCEPTIONS OF CHANGES IN THE TREATMENT OF FOREIGN INVESTMENT IN LATIN AMERICA
(Percentages)

	Argentina	Brazil	Mexico	Venez'la	Chile	Colombia	Ecuador	Peru	CostaR	El Sal	Guat'la	Honduras
Treatment is Better	10	3	32	21	26	23	21	4	14	-	-	-
There has been no Change	60	72	36	43	63	59	68	30	86	88	87	100
Treatment is Worse	30	25	32	36	11	18	10	65	-	12	13	-
Number Responding	30	36	34	28	19	22	19	23	14	8	15	12

Part IV: The Prospects for Economic Policy Reforms in Latin America

Introduction

Many current policy recommendations assume that the changes being urged upon Latin American and other third world governments will result in greater private sector investment in the various countries and regions. Many recommendations to governments presume domestic or multinational interest in purchasing state-owned enterprises or local currency for investment. Because of the importance of private sector attitudes in most of the policy formulae being discussed today, the Council sought to use its survey to tap responding members' reactions to current policy recommendations.

A. The Outlook for Structural Reforms in Latin America

Interest in Privatization of State-Owned Enterprises

Companies expressed an overwhelmingly negative reaction (98%) when asked if they would have any interest in purchasing all or part of a country's State-owned enterprises. Nevertheless, at least one company expressed interest in State-owned enterprises in each of the four major economies, the Andean countries and Chile.

Purchase of Debt at Discount to Acquire Local Currency

Companies were asked whether they had purchased debt to acquire local currency in any of the countries. Responses suggest that some discounted debt is being purchased to acquire local currency. Nineteen such purchases were reported, predominantly in Argentina (8), Brazil (5) and Mexico (3). However, the majority of respondents reported that they had not made purchases of discounted debt and would not be interested in doing so. One-third of companies responding on Brazil and Mexico indicate that they either had plans or could be encouraged to purchase debt at a discount in the future. A smaller percentage of companies indicated that they could be persuaded to purchase discounted debt in the Andean countries and in Chile.

Not all companies reporting that they had made purchases of discounted debt revealed the size of their purchases. Those reporting indicated purchases ranging from $1 million to $50 million. The Survey Task Team observed that these are relatively small amounts in relation to the size of the reporting multinational companies.

Debt-to-Equity Conversions

By and large companies reported that they had not converted and had no plans to convert debt to equity. Nevertheless, one-third of the companies reporting indicated that they had converted some debt to equity in both Brazil and Mexico. One-fourth of the companies responding on Peru indicated they had converted some debt to equity in that country.

The Council's 1984 survey reported a similarly low incidence of debt-to-equity conversions. Nevertheless, members of the Survey Task Team suggested that the debt-to-equity market only became very active in 1986. Current reporting in the media seems to suggest more debt-to-equity conversions that are reflected in the Council's survey data. The Task Team noted, however, that banks and financial institutions have completed the majority of such conversions and their activity is not reflected in the survey.

Role of the State

Latin American countries have experienced pressure from a broad spectrum of authorities to take steps to reduce the role of the public sector (the State) in their economies as a means to stimulating growth. A number of countries have taken concrete action to reduce State involvement in the local economy. Others have expressed the intention to make changes, but have not implemented them vigorously.

for reducing export obstacles, changing tax structures and privatizing state-owned enterprises.

Policy Approaches: Baker versus Bradley

A variety of approaches, ranging from total write-off to continued austerity without new money, have been proposed for dealing with Latin American countries' continued severe indebtedness. The key goal in all approaches is to restart growth in the region. In addition to the peoples of Latin America itself, investors, as well as banks, have a profound stake in an early return to growth. The Council of the Americas' 1983 and 1984 survey's indicated that equity investors had lost billions of dollars of sales because of the Latin American recession. Those earlier surveys and the present one all indicate the region's poor economic performance is the key factor affecting business performance and investment prospects.

The two most recent widely discussed approaches to the Latin American debt are those proposed by Secretary of the Treasury James A. Baker, III and U.S. Senator Bill Bradley (D-NJ). In October 1985 Secretary Baker proposed a "Program for Sustained Growth" for fifteen major debtor nations (10 in Latin America). The program was intended to end austerity and fuel growth through a commitment of $29 billion in new loans over a three-year period. New loans would be contingent on countries' commitment to structural economic reform. Commercial banks were expected to provide $20 billion in new lending, and the multilateral development banks would provide $9 billion in structural adjustment loans.

Senator Bradley proposed his alternative in June 1986. The Bradley plan called for three points of interest rate relief and a write-down and forgiveness of three percent of principal annually for debtors undertaking serious structural reforms. Three billion dollars of new multilateral lending would also be made available to eligible countries. Bradley's approach is intended to address the concerns that new debt is unhealthy for both debtors and creditors, and that ongoing debt servicing requirements prevent debtor countries from devoting foreign exchange earnings to imports, thus contributing to the U.S. trade deficit.

The Council's survey sought businessmen's assessments of the assumptions underlying the various debt proposals, particularly Baker and Bradley. Respondents expressed a wide diversity of opinions when asked what approach to managing the debt crisis is likely to have the greatest effect in improving business prospects in Latin America. The majority of respondents indicated support for a Baker- or Bradley-type program, with a slight bias in favor of the adjustment in interest burden and payback schedules of the Bradley proposal. There was very little support for major new capital inflows without strings or for the case-by-case approach that has been followed to date which has meant severely constrained access to foreign exchange for MNC equity investors. Very few respondents believed it would help to write off the debt altogether and start over.

Companies were also asked to indicate the three most promising areas to which new lending should be targeted in order that growth be restored more efficiently. From a list of nine options, the clear first choice in each country was the local private sector. Funding for infrastructure was the leading second choice and trade financing ranked third. Project financing and debt repayment were also mentioned frequently.

The Survey Task Team observed that interpretations of responses on approaches to the Latin American debt need to take into account that no Council bank members participated in the survey and that member banks very likely would not be supportive of a program involving write-offs of the debt or programs of reduction in interest payment. At the same time, the Task Team acknowledged a widespread feeling among the equity investor community that countries' heavy obligations to the banking community have a direct impact on their ability to present attractive investment opportunities.

B. Other Policy Issues

Use of Mixed-credits by Non-U.S. Competitors

Tied aid credit, or "mixed credit" is a government export financing loan that contains a subsidy or grant element. The permitted grant element portion is set by the OECD Arrangement on Export Credit, the international agreement governing official export credits. The Arrangement sets the minimum interest rates for official export credit and provides a formula for computing the "grant element" contained in tied aid credit. The Arrangement prohibits tied aid credit with a grant element of more than 25 percent.

investments. The Survey Task Team recognized that non-commercial risk insurance might be more important to smaller investors or to investors that did not have the experience of the Council membership in operating in Latin America.

Tactics for Achieving Better Foreign Investment Rules

Companies were asked to indicate what they believed are the best tactics to use with Latin American countries to achieve better rules on foreign direct investment, technology transfer and intellectual property protection. From a list of eight possible tactics, the companies indicated a clear first preference for "high level, government-to-government discussion." "Reasoning with local officials" was the second preference and "Council of the Americas meetings between members and government officials" was the third most-mentioned choice. Table 21 shows the responses received to this question.

TABLE 21
RANK ORDERING OF BEST TACTICS FOR
ACHIEVING BETTER FOREIGN INVESTMENT RULES
(Number of companies responding)

	First Choice	Second Choice	Third Choice
Reason with local officials	11	10	1
Section 301 "fair trade practices" cases	4	2	3
Council of the Americas meetings with government officials	5	6	11
U.S. industry-specific trade associations	1	5	3
High level, government-to-government discussion	19	13	2
Mid-level, government-to-government negotiation	3	6	10
Internat'l organiz'n efforts	3	3	9
Specialized consultants/ law firms	-	1	4

U.S. Government Support for U.S. Investors

Companies were asked whether the scope of U.S. government assistance and backing to U.S. private firms in Latin America should be greater, the same as or less than at present. Companies were also asked to rate the quality of assistance provided them by the U.S. Embassy in the countries in which they operate and by the U.S. Government in Washington.

By a margin of two to one, respondents indicated that U.S. Government assistance should be greater than at present. Respondents rated both the U.S. embassies and the U.S. Government in Washington as "not involved" in helping companies operating in Latin American countries. Embassies in Argentina and Venezuela got more positive ratings than those in Brazil and Mexico, while the Andean country and Central American embassies were generally rated as "not involved." The remaining responses tended to concentrate in the "good" and "fair" categories with a few "excellent" and "poor" ratings. The ratio of "good" and "fair" ratings for embassies as compared to the "not involved" assessment varied on average from 2:3 and 1:3. Companies rated the U.S. government in Washington as less helpful than embassies.

Informal Sector

Considerable attention is being given to the importance of the "informal" sector (non-registered small business or underground economy) in Latin American countries. It is suggested that many country economies are considerably better off than their national accounts would suggest because of the entrepreneurship and employment generation in the informal sector. Hernando de Soto of the Instituto Libertad y Democracia in Lima, Peru, reports that 40 percent of the Peruvian economy is in the informal sector. Another observer suggested that a poor country like Bolivia had not experienced more disastrous effects from uncontrolled inflation because most economic activity had moved into the informal sector. Whatever the causes, the presence of a large and growing informal sector in Latin American countries has potential implications for the operation of multinational firms. The Council asked members to estimate the size of the informal economy in the countries in which they operate and to comment whether they deal with elements of the informal sector (a possible indicator of the pervasiveness of the

COUNCIL OF THE AMERICAS

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Chairman

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H.J. Heinz Company
Honeywell, Inc.
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Ibec Inc.
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Ingersoll-Rand Company
Irving Trust Company
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Johnson & Higgins
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G.D. Searle & Co.
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Tesoro Petroleum Corporation
Texaco Inc.
Texas Eastern Corporation
Texas Instruments Incorporated

Union Carbide Pan America, Inc.
Uniroyal Latin America
United Brands Company
United Technologies Corporation
Vick Americas/Far East Division of Richardson-Vicks Inc.

Wells Fargo Bank, N.A.
Westinghouse Electric Corporation
Westvaco Corporation
World Trade Center of New Orleans

Xerox Corporation

Arthur Young & Company

Senator **Bradley**. I would like to thank the whole panel for the testimony. I think that it is a very diverse group, and I think it has given us a lot of valuable information. Mr. Fites, if I could ask you: The chart that you have before us is 1980 to 1986. What would those numbers be if you began in 1982?

Mr. **Fites**. Mr. Chairman, in 1982 those numbers would be about—I would say—halfway down. I think you would probably see around $185 million of exports and around 6,000 jobs in 1982. It has been a steady decline over that period.

Senator **Bradley**. So, 1980 was the high point?

Mr. **Fites**. Actually, the high point was around 1978.

Senator **Bradley**. So, what we are trying to do here is to determine the effect of the debt crisis on jobs.

Mr. **Fites**. Right.

Senator **Bradley**. In the manufacturing sector. And so, the job loss would be roughly 6,000 to 1,200 in terms of 1982 to 1986.

Mr. **Fites**. Roughly, that would be so.

Senator **Bradley**. 6,000 jobs cut in your firm to 1,200 jobs.

Mr. **Fites**. That is the total for caterpillar and its U.S. suppliers.

Senator **Bradley**. Now, you say you face a myriad of problems, not just Third World debt, but trade barriers, etcetera, etcetera. Have you seen an increase in trade barriers?

Mr. **Fites**. We think we have seen a perceptive increase in trade barriers over this period of time in most Latin American countries, but certainly in Brazil, Argentina, Mexico. We have manufacturing facilities there, but the percentage of local content gets ratcheted up. We also have export quotas placed upon us. In order to import a dollar's worth of components into Brazil, we must export $3.00. So, while some of our products might have 80 or 95 percent local content, we still have to generate that export quota to get the imported components in.

Senator **Bradley**. Have you seen an increase in barriers since 1982?

Mr. **Fites**. Yes, we have. I think we are seeing a continuing increase in trade barriers, and I think I referred to that in my testimony. When we talk to foreign governmental officials—and we certainly talk to them all the time—they say, well, how do you expect us to pay your debt unless you export or unless we curtail your imports?

I have even heard some of our own trade officials, when we complain to them about the barriers that we face, come out with the same logic.

Senator **Bradley**. So, essentially the interests of Caterpillar, specifically, but manufacturing in general are being subordinated to other interests. Is that the gyst of your comments?

Mr. **Fites**. They certainly are, Senator. Of course, I think for years they have been subordinated to other interests, not only the debt problem. I think trade interests in this country bave been subordinated to defense issues, they have been subordinated to Department of State issues, and others, compared to the countries that we compete with. Today in our business, that is primarily Japan and West Germany. There are no large exporters of our type of equipment in the United States that have survived; and Japan and West

Germany, I can assure you, have trade very high on their policy agenda.

Senator **Bradley**. You also made the point in your testimony that you have certain financial exposure in these developing countries. You said Caterpillar's exposure is more than $650 million; more than $300 million of this results from export trade receivables in support of our Caterpillar dealers retail outlets. Now, as someone with financial exposure, how do you propose to deal with that?

Mr. **Fites**. We wanted to insert that to urge you to move with a certain amount of prudence on whatever action the committee or the Government decides to take because there is not only bank exposure that is at risk here, but all private industry that exports to Latin America or anywhere else in the world has exposure. So, we are talking not only about bank problems here; we are talking about U.S. business problems, and that is the reason we wanted to insert that statement.

Senator **Bradley**. So that you would be seen not only as manufacturing but also financial?

Mr. **Fites**. Yes. That is correct.

Senator **Bradley**. Senator Rockefeller?

Senator **Rockefeller**. Mr. Fites, Komatsu is your major worldwide competitor?

Mr. **Fites**. That is true.

Senator **Rockefeller**. How are they doing in Latin America?

Mr. **Fites**. I am happy to report that we have held our market share in Latin America. Komatsu has basically replaced other U.S. manufacturers. I can also report that we have held our market share around the world over the last decade, but several other U.S. companies are no longer in this business.

It is not a case that we have lost the sales or we have lost the employment because we have lost our share of the market; it is a case that the market has basically declined to that extent.

Senator **Rockefeller**. You indicated in your testimony that you are undertaking a variety of strategies to make your products technologically superior?

Mr. **Fites**. Right.

Senator **Rockefeller**. And I assume that means a lot of research and development. What are you doing?

Mr. **Fites**. We are investing more than one billion dollars in modernizing our manufacturing facilities. We have announced that plan. About 70 percent of that will be invested in our U.S. facilities. We do have facilities outside the U.S., but the majority of that will be invested in our U.S. facilities. We are continuing to spend more money than anybody else on research and development in the construction equipment industries we serve. That is the bottom line to being competitive.

We can heap many of our trade problems on the debt issue, but in the end, you have to be competitive; and I think we are competitive. I think Boeing is competitive. I think the soybean farmers are competitive; but there are a lot of other industries in this country that, if the debt problem went away, would still have trade problems that will not go away because they are not competitive.

Senator ROCKEFELLER. In that line, you do a certain amount of assembling and work overseas, do you not?

Mr. FITES. Yes, we do.

Senator ROCKEFELLER. And then, it comes back to this country for final processing?

Mr. FITES. To put it in perspective, 75 percent of what we sell around the world is made in the U.S.; 25 is made outside the U.S. We do roughly 50 percent of our business inside the U.S. and 50 percent outside.

Senator ROCKEFELLER. If the world debt situation stabilized to a reasonable degree, would that effect your decisions as to the 25 percent that you produce in other countries around the world? Or is that simply a global strategy at work?

Mr. FITES. I am not sure it is the global economy because, if we go back not too long ago—in 1981—rather than 75 percent, 81 percent of our product was made in the U.S. Now, what we have seen here is that some of the markets that we normally would serve from the U.S.—and Latin America is a good example and Mexico is a good example—have so declined that it has distorted the overall ratio of what we make in the U.S. and outside the U.S.; but resolution of the debt problem would certainly increase exports, and we could probably get that number back up again, around two or three percent. I don't think it will ever go back to 1981.

Senator ROCKEFELLER. Mr. Plunket, you discussed U.S. job losses resulting from the international debt crisis, but there are some losses that don't necessarily result from the crisis. I am thinking specifically of a very sensitive point in my own State, a Volkswagen plant. It is state of the art techonlogy and, does the stamping for a plant in Pennsylvania for Volkswagen of America. They have recently moved this plant out of West Virginia, down to Mexico, not for—as I would understand it—international debt reasons but for macroeconomic reasons, and also, quite frankly, lower wages in Mexico. Now, that is job loss that does not relate to international debt. What would you do about that?

Mr. PLUNKET. Senator, I would think that is largely a result of the difference in wage rates between West Virginia and the north of Mexico. I don't know what you can do about it. You gentlemen can prohibit or make expensive the import of those items from Mexico, if you feel that is a desirable thing to do. I don't know what else you can do about it frankly; and that, obviously, has the effect of making those items more expensive to the U.S. consumer and aggravating the flow of illegal immigration from those in Mexico, among other things.

I think it is a result of what you referred to as the global economy. I think that is part of the global economy; wage rates for unskilled labor in the U.S., I am told, are about $12.00 an hour; in Korea and Singapore about $2.00 an hour; in northern Mexico less than $1.00 an hour. And I think it is a competitive item. There may be areas in which the U.S. worker has priced himself out of the market.

Senator ROCKEFELLER. Thank you, sir. One final question, Mr. Chairman. Dr. Hayes, I was struck by your testimony. I was struck generally by its pessimism, a very great sense of pessimism; and you moved back and forth so as not to appear to be too pessimistic, but it struck me that you were. On the third page of your testimony, you say: "Most companies anticipated a much better time by the 1990 and 1995 time frame."

And yet, there was a profound sense of uncertainty & pessimism about whether Government reforms would be implemented. What makes you look forward to those five years with some degree of optimism?

Dr. **Hayes**. There is a table 3 in the full survey report which reveals why I said that by 1990 to 1995, companies seemed to be more optimistic. I think it is because there is a feeling that we will have passed some of this period of debt crisis, and the countries will have begun to grow again. Once their economies grow, businesses will begin to realize increased sales, although not necessarily the volume of sales that they would like to realize because of issues like market reserves and local content requirements and others. So, the optimistic side is that there is an expectation that these economies will begin to grow in the mid-term and beyond.

The pessimistic side is that they will continue to be very protectionist on their side and, therefore, not necessarily good places for U.S. corporations to be.

Senator **Rockefeller**. The optimistic side then assumes a working out of the international debt problem. You don't have advice for us on how you would do it, but it assumes that——

Dr. **Hayes**. It presumes that there will be at least a muddling through on the debt side, that we will not have a crisis.

Senator **Rockefeller**. That there will be something done differently from what we are doing today?

Dr. **Hayes**. I can't say that. We asked the question of the corporations—the equity investors in Latin America—as to their attitude toward various solutions to the debt crisis; and they did not favor any particular solution. They weren't particularly happy with the muddle-through that we have gone through so far. They weren't particularly in favor of what we characterized as Senator Bradley's proposal or other proposals; and I think our bank members, of course, would have had a very different response to that particular question. They were not included in the survey.

Senator **Rockefeller**. Thank you, Mr. Chairman.

Senator **Bradley**. Thank you, Senator Rockefeller.

Mr. Fites, if I can just get your sense: Do you think that U.S. manufacturers, exporters, have had to shoulder a bigger share of the burden for failed debt policies in Latin America?

Mr. **Fites**. I think that U.S. corporations are shouldering the burden—a great deal of the burden—for the debt problems that we have in Latin America and in other countries because, in effect, we have had to curtail exports; we have had to make investments—redundant investments—in many countries to produce locally or forego the market place. And then, as a further step, in order to operate those facilities, we have had to meet export quotas from those facilities, in order to preserve foreign exchange and create foreign exchange. So, yes, I would say as I look at the whole spectrum of government, business, and banking, I think it has been U.S. business that has shouldered a great deal of the burden of the debt problem.

Senator BRADLEY. Can you compare Caterpillar's performance in Latin America with the performance of the banks that have lent heavily to Latin America over the last couple of years?

Mr. FITES. Of course, these banks are our friends. They loan us money; they help finance us. I will just say this, Mr. Chairman, that if we make a bad tractor and it breaks down on the customer's job, it ends up hurting us. If we make a thousand bad tractors—it hurts us a lot. That is the nature of our business. I would presume that bankers are also subject to the laws of economics; and if you make a bad loan, presumably there is something other than full reward for that type of financial operation.

Senator BRADLEY. So, you are telling us that you can't lend yourself new tractors?

Mr. FITES. That is for sure. [Laughter.]

Senator BRADLEY. Dr. Hayes, you said that there was uniformly—and I am picking up on what Senator Rockefeller said about pessimism—there was uniformly a feeling that the economic climate had to be improved in Latin America. Now, specifically, were there one or two things that your members suggested—as opposed to the economic climate—but what one or two things? If you were going to give the committee two things that would summarize—or two things, you don't have to summarize—but two things that you think are the two most important things that Latin American countries could do to improve the economic climate?

Dr. HAYES. We defined the economic climate in this survey as a macroeconomic situation, which is very heavily influenced by debt burden and so forth. And therefore, I think the members recognized that that macroeconomic situation has to be remedied in some way. I think they also feel that the domestic business climate—and this would be point number two—also has to be improved rather dramatically. The kind of structural reforms that the World Bank is presently engaging in in its policy lending are very helpful there. Trade barriers have to be reduced so that companies can import. Price controls have to be removed so that they can make money. Interest rates have to be more equitable.

Senator BRADLEY. Take the open economy and price controls; those are two specific things that you think would improve the economic climate in these countries. Now, let me ask each of you the question: Would you support as the United States heads into the new GATT round using debt and interest rate relief as a leverage to open up these economies to U.S. exports and to reduce the barriers? Mr. Plunket?

Mr. PLUNKET. I think we would, sir. If one compares the 1985 report of the STR on trade barriers with the 1986 report, I think one will be impressed with the changes which Mexico has made without any such encouragement. However, it must be admitted that there has been great resistance on the part of some other countries—some other Latin American countries. We are basically for open trade because we make a living out of trade, and I think that whatever diplomatic encouragement or ploys can be used are justified. Yes.

Senator BRADLEY. Mr. LaRocco?

Mr. LAROCCO. We think that the number one priority is to get the domestic economic engines of the Latin American countries restarted. We are looking at somewhere between a 45 to 50 percent decline in exports through the Port of New York/New Jersey, and the way to begin that—to rebegin, to climb back out of the hole—is the reinvigoration of the domestic economies in Latin American countries.

Senator **Bradley**. And the access to the markets?

Mr. **LaRocco**. Correct.

Senator **Bradley**. Dr. Hayes?

Dr. **Hayes**. I think any kind of relief has to be heavily conditioned upon reform first, and here the difficulty is how does one leverage reform, which takes a long time, while engaging in relief, which takes a short time.

Senator **Bradley**. Mr. Fites?

Mr. **Fites**. I don't think I would, Senator. I think the GATT negotiations are going to be extremely difficult. I have talked to many of our negotiators who are involved in that process. We have many issues that we need to work on, including intellectual property rights. I believe the debt issue needs to be set aside and worked on as a separate issue.

Senator **Bradley**. As a separate issue? So, you think you will be able to get access to markets, given the leverage tools that you have available?

Mr. **Fites**. Well, being a practical person, as I think our negotiators are, I feel that they are going to have enough problems winning some of the innings in the GATT negotiations without interjecting the debt issue. I think it will be very, very complicated if we try to interject the debt issue into GATT negotiations.

Senator **Bradley**. I see.

Mr. **Fites**. It is in the background, and it may be an important lever; but I wouldn't want to make solving the debt crisis one of the major objectives of the GATT negotiations.

Senator **Bradley**. So, you don't deny that it does give leverage to the United States. You just say that it will be too many items on the agenda?

Mr. **Fites**. Right. In essence, yes.

Senator **Bradley**. I was intrigued by your characterization that maybe the debt negotiation should be taking place maybe 1,000 miles away and not a part of the GATT negotiations, but simultaneity has a marvelous way of conveying influence. Is that what you said?

Mr. **Fites**. I am saying that it is a side issue and it can be used as a lever, but it should not be interjected into the GATT negotiations as a key factor because it will so complicate those negotiations that I am afraid we will never get around to making any trade agreements.

Senator **Bradley**. Senator Rockefeller, any further questions?

Senator **Rockefeller**. No, Mr. Chairman.

Senator **Bradley**. Let me thank the panel very much for your testimony. It has been very helpful. This subcommittee will convene in two weeks for another hearing, and that hearing, we hope, will get around to some of the prescriptions as today's hearings got to the point of the effect and impact of this debt crisis on North, Central, and South America.

Let me thank all of you. The committee is adjourned.

[Whereupon, at 12:30 p.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

COMBUSTION ENGINEERING

Statement By
Combustion Engineering, Inc.

Impact of the Latin American Debt Crisis on U.S. Trade and Jobs

Subcommittee on International Debt

of the

Senate Finance Committee

March 23, 1987

Combustion Engineering
1101 Fifteenth Street, N.W.
Suite 500
Washington, D.C. 20005
(202) 429-9180

Combustion Engineering is pleased to submit this statement and requests that it be made part of the record of hearings on the impact of the Latin American debt crisis on Americans.

Combustion Engineering, Inc. is a multinational company that provides engineered products, systems, and services to the power, process, and public-sector markets. Our corporate headquarters is in Connecticut; the headquarters of our engineering and construction company, Lummus Crest, is in Bloomfield, New Jersey.

Like many American companies, Combustion Engineering has undergone enormous change in the past four years. To maintain our competitiveness both at home and abroad, we have reduced employment levels and manufacturing capacity, changed our product mix, and targeted new markets. In 1981, Combustion Engineering employed 46,704 people. By 1986, the number had shrunk to 24,149. Lummus Crest, which was among the world's five top engineering and construction companies in 1981 employing over 7,000 people, had a workforce of 1,984 people five years later. In 1981, the company was a major supplier of exploration, production, and processing equipment for oil and gas. In 1986, C-E sold its Vetco Gray oil and gas subsidiary.

There are many reasons for these changes in the company -- mature markets at home, the high value of the dollar, declining oil prices, and the international debt crisis. The latter two have had a particularly strong impact on C-E both because of our interests in the oil and gas business and our extensive involvement in international markets. Simply stated, we cannot sell if our customers do not have the financial resources to buy. Our experience in Latin America bears this out. In one country after another major projects have been postponed or cancelled because governments did not have money to pay for them and could not -- or would not -- incur new debts to cover them. To illustrate, we will cite two examples: a process engineering and construction project in Venezuela and a hydroelectric power project in Brazil.

In 1981, Lummus was awarded one of the largest and most sought-after projects of its kind -- the multi-billion dollar (total installed cost) Lagoven crude oil upgrading project in Venezuela. The company established a procurement office dedicated solely to this project in anticipation of letting hundreds of subcontracts to smaller suppliers in the

U.S. and Venezuela. Anticipated project-related new employment was to have been 1,000 people, 500 of whom would have been in Bloomfield, NJ. The project was cancelled in 1982. The timing suggests a correlation between the decline in oil prices, the resulting financial constraint, and the cancellation of the project.

The decline in oil prices hit the Venezuelan economy particularly hard. The petroleum industry, which directly employed about 1% of the labor force in 1982, generated 75% of government revenues and 90% of export earnings. When the export price of oil declined from $29 per barrel, export revenues dropped from $19 billion in 1981 to $14.5 billion in 1982. Venezuela could no longer afford an expensive project in a declining industry. The effect was felt 3,000 miles away in New Jersey. For Lummus, it meant a critical loss of both income and jobs.

Our second example comes from the experience of another C-E company, C-E/Neyrpic, which provides equipment for hydroelectric power plants. In April 1983, the United States signed five Memoranda of Understanding with the Brazilian government. Under these MOU's, U.S. companies were given first negotiating rights for five power projects, among them the Sao Felix hydro project for which the Brazilians selected C-E. The MOU process helped give a high priority to Sao Felix, but this was not enough to overcome the absence of the financing needed to bring the project to commercial realization. The project would have included the export of $150 million worth of U.S. equipment.

With respect to these two projects we can say with complete certainty that had they gone forward, C-E would have benefitted. Potentially of equal or even greater importance, however, is the attached list of other projects in selected Latin American countries which C-E has pursued, but which have been postponed or cancelled. Where available, we have indicated their dollar value and the number of manhours of work that would have been created had they gone forward. We believe that in each case, financing was an important and possibly determining factor in the customer's decision. This list is illustrative only and by no means exhausts the export opportunities, which C-E actively pursued in Latin countries over the past five years. The list would be even longer if we added countries in other parts of the world where mounting debt depressed our overseas markets.

We commend the Chairman for holding these hearings and thereby drawing attention to the very important connection between the external debt crisis and jobs at home. C-E has long recognized the potential of Latin American and other developing countries as markets for our products. For that reason, we have supported policies that would enhance the purchasing power of these countries and thus improve their ability to buy from the U.S. In particular, we have opposed textile quota legislation, the elimination of Generalized System of Preference benefits to advanced LDC's, and changes in the countervailing duty law to apply to natural resource "subsidies." But while these measures affect particular industrial sectors, the debt crisis cuts across the board. We therefore support the Chairman's effort to generate constructive proposals regarding debt relief in the context of broad structural reforms and multilateral negotiations. We have hope that the current hearings and related legislative initiatives will prove to be a significant step toward resolving the difficult issue before us today, the Latin American debt crisis.

FMH316M1

Attachment

ILLUSTRATIVE LIST OF
MAJOR PROJECTS CANCELLED OR POSTPONED

Argentina	SEGBA (Sociedad Electrica del Gran Buenos Aires) SEGBA has, in storage, a 350 MW turbine and planned in '81 - '82 to purchase the corresponding Peaking Unit boiler. Project apparently has been postponed indefinitely. Export value: $50-60 million; Labor: 375 man/years. Yacyreta Binacional Hydro Project (Argentina/Paraguay). This project on the Parana River was active during '83/84 period. Even though site preparations had been started, the project apparently has been halted. Export value: $200 million; Labor: 1020 man/years.
Chile	Both Chilectra as well as ENDESA had been planning in the early '80's to install each an additional 300±MW coal fired power plant, simultaneous with planned development of Chilean coal mines and shipping ports in Southern Chile. These fossil-fired plants were being planned near Santiago; however, have been indefinitely postponed. Export value: $50-100 million; Labor: 625-1200 man/years. ENDESA as part of the SING Project (Sistema de Interconneccion del Norte Grande) has been planning a 125 MW unit at Mejillones, near Antofagasta. Project is apparently being delayed 2-3 years. ENDESA, CHILECTRA and the Copper Mining Industry all had large scale plans in '83/'84 to further develop hydroelectric projects in the Andes. Planning and construction of these projects has been cut back to at least 25% of the former planned MW.
Columbia	CORELCA - Cartagena IV (Corporacion Electricia de la Costa Atlantica) In 1983 CE actively pursued this CORELCA project and negotiated a controlled circulaation license with Distral S.A. for this 300 MW coal fired plant. The unit was subsequently downsized to 150 MW. Project now is on hold. Export value: $20-40 million; Labor: 250 man/years.

AMAGA - ISA (Interconexion Electrica, S.A.) Medellin, 150 MW coal fired power plant. Project apparently will be cancelled.

Additional coal fired projects planned for mid '80's which have all been post-poned are 150 MW units at Paipa IV, Zipaquira VI and a large new 300 MW station in Boyaca, Colombia. All these fossil projects are now delayed to the mid-1990's.

Dominican Republic

CDE (Corporacion Dominicana de Electricidad): Following installation of Itabo I and II, CDE had planned additional 125 MW PC fired units at this station, as well as in Samana area. Since 1985, all progress on these additional power plants has apparently been halted.

Jamaica

Since 1983 C-E has been actively involved in additional fossil plants for Jamaica Public Service, first at Old Habour, and later as co-generation at Clarendon. All these projects have been halted due to Jamaica's financing problems.

Mexico

Comision Federal de Electricidad (CFE) had published in the early 1980's an ambitious expansion program for its fossil power projects throughout Mexico. The projects on this Fossil Plant listing are being postponed and reduced annually. The latest project, which was scheduled for initial tendering in 1987, 2 x 350 MW units at Altamira, has now been delayed until 1989.

In 1982 and 1983 the CFE initiated the procurement of two 1000± MW nuclear power plants for the Laguna Verde Nuclear Project. These projects have been abandoned. Similarly, construction of the first two boiling water reactors at Laguna Verde has been delayed.

Peru

During the 1982/83 period, ELECTROPERU planned to purchase two 200± MW coal fired units for installation at the Alto Chicama Anthracite coal mines. This project has apparently been indefinitely postponed. Export value $50-60 million.

Venezuela

CE/Neyrpic was pursuing the Bajo Caroni project with EDELCA in the lower Caroni River Basin, which would have allowed utilization of the bulb turbine technology. Specifications were being prepared by EDELCA with Harza Engineering during the 1982/83 period. This project, apparently, has since been halted.

CADAFE, in the southwestern region of Venezuela, had started construction of a large hydroelectric Uribante-Caparro Project. This project was halted in 1984, and at this time it appers that only one of the three power stations of this project may be completed.

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U.S.

Testimony of

Archbishop Rembert Weakland, O.S.B.
Archbishop of Milwaukee

for the

U.S. Catholic Conference

before the

Subcommittee on Foreign Operations
House Appropriations Committee

on

Third World Debt and U.S. Policy: Ethical Reflections

March 4, 1987

Mr. Chairman: I testify today on behalf of the U.S. Catholic Conference (USCC) the public policy arm of the Catholic Bishops of the United States. I express the appreciation of the USCC for the invitation to appear before this Committee. I welcome the opportunity to offer some remarks on behalf of the USCC on the increasingly serious and urgent problem of the debt of the Third World countries, which now stands at $1.035 trillion, according to the World Bank.

I am sure you are aware that last November the U.S. Catholic bishops approved a pastoral letter on the U.S. economy, entitled "Economic Justice for All." I had the privilege of chairing the five-man ad hoc committee of bishops who spent five years preparing the draft of that document. During those five years the committee members were exposed to a broad range of opinion on the economic policy issues we had chosen to address -- one of which, The U.S. Economy and the Developing Nations, included the subject of this hearing.

As I have pointed out to other Congressional bodies, our Catholic tradition recognizes the crucial importance of the kind of empirical analysis and technical competence on issues of public policy that we have just heard; these are clear prerequisites for reaching fair and effective decisions on these complex issues.

During the preparation of our letter we conducted a series of hearings at which many professional economists provided us valuable insights into how the system works and how it might be improved. But we believe that the economic analysis must be complemented by a moral perspective that reflects the human needs, the real people, the human problems, behind the statistics and the economic indicators. Economic decisions affect human persons and are therefore fundamentally moral.

The argument of our pastoral letter rests on three premises: first, the dignity of the human person created in the image of God is the measure against which every economic decision, policy, and institution must be judged; second, because this human dignity can be realized only in community, every person has a right to participate in the economic life of the society; third, all members of the society have a special obligation to the poor and the disadvantaged. For us, the ultimate test of justice is how the economic policy choice affects the poor.

We find ourselves, therefore, at the intersection of empirical economic analysis and the normative questions of value and human purpose. While we acknowledge that our three perspectives do not lead directly to specific conclusions about policy -- that is, that there can be no purely moral approach to economic choices -- we nevertheless insist that purely empirical economic analyses cannot produce, by themselves, an adequate policy, either.

The formulation and implementation of economic policies cannot be left solely to technicians, special interest groups, and market forces; it must also centrally involve ethical values and moral priorities. We also believe that the perspective of Catholic teaching provides a point of entry and an angle of vision distinct from, and an indispensable supplement for, that of the professional economist.

We decided to treat the Third World debt situation, at least briefly, in our letter partly because the dynamic of our process and the thinking I have just summarized led us in that direction -- and partly, too, because our discussions with our fellow bishops from Latin America and the many communications we have received from American missionaries serving in the Third World added a note of personal urgency to the more detached conclusions of our analysis.

We believe very strongly that a debt burden which resulted in a net transfer of nearly $30 billion in 1986 to the industrialized countries (principally the United States) from countries in which upwards of 800 million people live in poverty so miserable that it is "beneath any rational definition of human decency," in which hundreds of millions of people are chronically hungry, in which 40,000 children die every day from malnutrition and disease, in which two-thirds of the world's people live at an economic level that is increasingly below that of the industrialized world, is much more than a set of problems calling for a technical solution. It is a scandal; it calls for a moral solution that should entail significant sacrifices on the part of those who benefit materially from this situation.

In the international section of our pastoral letter we acknowledge, in the first place, what we term "The Complexity of Economic Relations in an Interdependent World." We say that these economic relations constitute "the framework in which the solidarity we seek on a national level finds its international expression." Although we recognize that the United States has economic relations with a whole spectrum of other nations, "our emphasis on the preferential option for the poor moves us to focus our attention mainly on U.S. relations with the Third World." Among those relations we give considerable prominence to international finance: "The debtor-creditor relationship exemplifies both the interdependence of the international economic order and its asymmetrical character, i.e., the dependence of the developing countries."

Although I am sure you are as aware as we are of the nature, dimensions, and causes of the present Third World debt situation, I believe it would be useful anyway to indicate to you how we see this matter from the angle of vision noted above.

The total aggregate debt of the developing countries has now gone beyond the $1 trillion we cited in our letter. The servicing of this enormous debt (the largest part of which is interest) entails an outflow of capital so huge that for all practical purposes it inhibits those countries' development -- whether development is viewed as economic growth or as improvement of the quality of life of poor people (which would be our preferred definition).

One might think from accounts in the media that the so-called debt crisis burst full-blown and unexpectedly on the world in August, 1982, when Mexico announced that it could not meet its debt servicing requirements. In fact, however, as you know, it had been accumulating throughout the 1970s at least, as food and energy prices rose sharply and newly rich oil-exporting countries invested their profits in the banks of the industrialized countries. Developing countries borrowed these funds to pay their increased energy and other import bills -- and then borrowed again when oil prices doubled once more at the end of the decade and falling prices for their commodity exports reduced their ability to service the debts incurred earlier.

Already at the beginning of the 1980s, before commercial lending began to decline and nearly three years before the Mexican announcement, the Brandt Commission noted that the borrowing needs of even the better-off developing countries were likely to rise considerably during the ensuing decade, at least partly because they would need to borrow more in order to service the debt already accrued. The Commission went on to observe that "The debtor economies and the entire international credit structure are now very vulnerable to any disruptions in the flows of capital." "The heart of the debt problem," it said, "is that a very large proportion of the funds are lent on terms which are onerous for borrowers from the point of view of both the repayment capacity of the projects they finance and the time debtor countries need to correct structural imbalances in their external accounts."

What is not always recognized is that developing country borrowing saved the industrialized countries from the full impact of the oil price rise. "Over the last few years," the Commission continued," economic activity in the industrialized countries has been sustained by a major recycling of financial surpluses through the commercial banks." The Commission quoted an OECD (Organization for Economic Cooperation and Development) report that says "Had developing countries followed the example of industrialized countries after 1973 by cutting back both their growth and imports to adjust to the oil price increase, the recession in the industrialized world would have been far more serious."

In other words, these countries of the South bailed out the industrialized countries of the North by quadrupling their own external debt in the decade of the 1970s. When oil prices doubled again in 1979, they were unable to repeat that performance, especially during the recession that ensued and as the terms of trade worsened for their exports. At the end of 1979 their debt was about $300 billion; the Brandt Commission estimated that another $500 billion might have to be added by 1985 unless the oil-importing countries checked their imports and their growth -- "provided the funds could be found." As is manifest in the trillion dollar total, those funds were found, until recently.

The Brandt Commission's prescription for relief was "massive transfers" of resources through concessional foreign aid and commercial lending, which would require "intermediation" by public institutions like the World Bank and the International Monetary Fund (IMF), since "private commercial banks...can no longer be counted on to conduct the recycling process unassisted." "All countries must share the burden," the Commission said and called for, among other things, a system of universal international taxation.

As we all know, all countries have not shared the burden; commercial lending has dwindled to a trickle; there is a large and growing net transfer of financial resources (nearly $30 billion last year) from poor people and poor countries to relatively rich countries and relatively rich people; the catch-phrases of the day are "policy reform," "structural adjustment," "conditionality," and "austerity."

This, in our summary view is the historical record. The prescriptions of the Brandt Commission -- and most others being considered now -- are either macroeconomic solutions, which do not take the human element adequately into consideration, or bandaids (some of them quite large) which treat only the symptoms, or efforts to lighten the debt burden so that these countries can buy our exports. As we wrote in our pastoral letter, however, the Third World debt crisis reveals a more fundamental systemic problem. What happened in the 1980s, like what happened in the decade before it, resulted not only from policy but from structure.

The broad outline of the post-World War II international financial system was established at the Bretton Woods Conference of 1944, which created the World Bank and the IMF and laid the foundation for the GATT (General Agreement on Tariffs and Trade). The purpose of these arrangements was to prevent the kind of economic action that were perceived to have led to the war. In the system that emerged the dollar was the dominant currency, much as the British pound sterling had been in the inter-war period; and its role as the basic medium of exchange led to nearly three decades of unprecedented economic growth and prosperity. Even after the United States terminated payment in gold, the dollar remained the dominant currency -- throughout the period and to the present day. As the dollar appreciated in price and dollar-denominated loans were rescheduled at higher interest rates (and with high rescheduling fees for the banks), the burden on the debtor countries grew steadily to its present dimensions.

Especially after the Mexican crisis of 1982, the rather limited number of major lenders (twenty in the United States) began to worry about the high proportions of their portfolios that were in Third World loans; the particular fear was that a major debtor might default, wipe out an important bank, and trigger a damaging process in the international financial system. From the debtors' side of the table (the perspective we emphasize in this testimony) the continuing payments are seen as threatening social stability in debtor countries, slowing down economic growth, and hindering efforts to improve the standard of living of the poor.

For many of us who are concerned with this problem of Third World debt, there is the further complication of how at least some of the borrowed money was spent. It is documented, for example, that capital flight from Third World countries has increased, as ruling and economic elites transferred funds into high-interest-paying accounts and investments in the industrialized countries. (I do not need to bore you with examples, since they are only too obvious.) The very banks that are paying interest on the foreign accounts of those elites are obtaining much of the money to do so by further penalizing and taxing workers and farmers in developing countries that are meeting their debt service burden. Then, when, as in 1982, a major country gets into difficulty, the banks either cease lending (but continue to insist on payment and therefore earn profits) or are cajoled into rescheduling loans, for which they increase the spread between the interest they pay on deposits and the interest they collect on the loans (and charge high fees for doing it).

It seems to us that the injustice in these circumstances is rather clear: first, poor people in poor countries are forced to pay back debts pushed on their not uneager but often unrepresentative governments by profit-seeking banks in the industrialized world; second, poor countries which shored up the industrialized world after the first oil shock, but could not do so after the second, are now required to continue -- and in fact, increase -- the net transfer of resources to the relatively rich North; third, workers and farmers in countries like the United States are losing jobs, income, and assets because their former customers either cannot afford to buy their products in view of the required debt repayments or are competing in those very markets in order to earn foreign exchange to pay back the debts; fourth, the bulk of this debt is interest, not principal. (Some, particularly in the Third World, ask whether the front-loading of interest in these circumstances could be considered usury.)

A Joint Economic Committee (JEC) report of last May, for example, estimated that U.S. agricultural exports to Latin America declined one third, prices of exported farm commodities fell about 20 per cent, and competing grain exports from Latin America more than doubled -- all because of the debt crisis of that region. The Brandt Commission was quite right to say: "All countries must share the burden." We would take it one step further: the creditor institutions, in particular, must share the burden.

In the midst of this malfunctioning system the IMF rose to quick and unexpected prominence in 1982. Originally established to provide short-term credit to countries that were having difficulties with their balance of payments, the IMF found its time frame unexpectedly lengthened because of the systemic problems that were emerging -- and thus was pushed into the role of a development agency. But the IMF's standard formula for meeting the short-term liquidity problems did not change: devalue the currency to encourage exports by lowering their price and thus earn foreign exchange; hold the line on wage increases to reduce the incentive to consume (and thus compete with exports); and cut consumer subsidies and public services to reduce inflation and the budget deficit.

These are the "austerity" measures associated with the IMF's standby agreements; the IMF insists that it does not "impose" these conditions. Moreover, former IMF Managing Director Jacques de Larosiere, at the World Bank/IMF meeting last fall expressed concern about "the most pernicious human costs" of the debt problem after having told ECOSOC last summer that a successful strategy must also "pay attention to the health, nutritional, and educational requirements of the most vulnerable groups.... For example, safeguarding human needs may imply that employment in overstaffed and loss-making public enterprises or defense spending be reduced in preference to cutting an accelerated immunization and health care program for children." There is little evidence, however, that this approach has yet carried over consistently into IMF practice.

In fact, the Third World debt problem up to now has been handled on an ad hoc basis by the IMF, the World Bank, the Federal Reserve Board, the Treasury, and, with considerable reluctance, the commercial banks. Notwithstanding M. de Larosiere's statements, the solutions have therefore been bankers' solutions; they have treated the matter solely as a macroeconomic problem and have emphasized economic growth, generally ignoring equity considerations altogether. The question has been posed this way: "how can the indebted countries achieve sustainable growth while continuing to make progress toward the restoration of normal debtor-creditor relationships?" The result of operating from this angle of vision has been that in order to sustain bank profitability (not just the soundness of the financial system), the IMF and its collaborators have insisted that foreign creditors of these debtor countries be paid in full and on time, even at the cost of reduced living standards and declining real incomes for the poor, increasing unemployment, steep price rises for food staples, and in some cases repression of fundamental human rights.

We fully agree with M. de Larosiere that "further progress on the debt problem depends critically on each of the major parties pulling his weight. Co-responsibility (used in his November 21 speech somewhat before it appeared in the recent Vatican document on debt) must therefore remain the cornerstone of the strategy. Second, a satisfactory solution to the problem...is feasible only in the context of durable growth in the debtor countries." We would add that such growth is unlikely and certainly undesirable without an at least commensurately equitable sharing of benefits and the decisions about them by the poor majorities in those countries. The international financial system should not be saved by the two groups least responsible for the current crisis -- the poor in the Third World and the taxpayers of industrialized countries like the United States (who will pay the bill if governments must shore up improvident banks).

We are pleased to see that pundits, politicians, and even some bankers are beginning to recognize that the creditors must accept a share of the sacrifices needed to resolve the Third World debt crisis. We believe, however, that it is reasonable to look carefully at two kinds of debt problems, at least. The first is that of, mainly, Latin American countries, which account for "roughly 40 per cent of the total external debt of all capital importing countries." Between 1981 and 1983, according to the IMF, net commercial lending to Latin America dropped from $55 billion to $1 billion, import volume decreased by 40 per cent, unemployment rose, and for all practical purposes growth stopped. More recently we have noted the dramatic announcements and actions by Mexico, Brazil, and Argentina. These events seem to us to be one more set of clear indications that the policies followed up to this point, in addition to being unfair, are also ineffective.

The debt of Sub-Saharan Africa poses a quite different problem. The bulk of it is owed not to commercial banks, but to governments or to the multilateral institutions created by governments -- the World Bank, the regional banks, and the IMF. As we pointed out in our pastoral letter, "although their aggregate debt of about $100 billion is only a quarter that of Latin America, their collateral (oil, minerals, manufactures, grain, etc.) is much less adequate, their ability to service external debt much weaker, and the possibility of their rescheduling it very small." In this case we believe that "forgiveness," perhaps in the guise of converting this official debt to a local-currency obligation to be paid into a development bank in the country, would be an appropriate and effective solution. Criteria for such conversion would, of course, have to be very carefully studied.

As we noted at the beginning, moral principles and doctrinal positions do not yield specific policies. They do not tell us, for example, how to choose among the score or more solutions proposed for this problem. But they do offer some general benchmarks against which to judge those proposals. We would look with great skepticism, for example, on solutions whose main objective and anticipated result would be to assure the creditors payment in full, or on proposals that consider the present problem one of temporary liquidity rather than incipient insolvency, or those that would create a new international institution to buy up bad debts from banks in exchange for newly issued bonds, or that would convert debt into equity at some kind of discount, etc.

In our view, none of these measures, as currently described, would improve the lot of the poor, since all of them are designed more to tinker with the system than to diagnose it in depth. The people least able to pay these debts and most burdened by them would not be helped by any of these proposals -- except, perhaps, in the now discredited sense of "trickle-down."

A new contribution to the debt debate is the recent publication of the Pontifical Commission Justitia et Pax, "At the Service of the Human Community: An Ethical Approach to the International Debt Question." In his introductory presentation, Roger Cardinal Etchegaray, President of the Commission, after summarizing the history of the crisis in much the same terms the U.S. bishops used, writes: "When credit agencies consider the situation solely from the economic and monetary angle, they often impose on the debtor countries terms, in exchange for accrued credit, that can contribute, at least in the short term, to unemployment, recession, and a drastic reduction in the standard of living. This causes suffering, first of all for the poorest as well as for certain sectors of the middle class. In brief, it is a situation that is intolerable and, in the medium term, disastrous for the creditors themselves. Debt servicing cannot be met at the price of the asphyxiation of a country's economy, and no government can morally demand of its people privations incompatible with human dignity...economic structures and financial mechanisms are at the service of the human person and not vice versa..."

The first of the ethical principles enunciated by the Vatican document is the very term used by the Managing Director of the IMF in his speech quoted above: co-responsibility. Both the U.S. bishops' letter and the Vatican document emphasize that "in order to be just, interdependence should give rise to new and broader expressions of solidarity which respect the equal dignity of all peoples... Solidarity implies an awareness and acceptance of co-responsibility for the causes and the solutions relative to international debt...the various partners must agree on an equitable sharing of the adjustment efforts and the necessary sacrifices, taking into account the priority to be given to the needs of the most deprived peoples. It is the responsibility of the countries that are better off to assure a larger share." ("An Ethical Approach")

The Pontifical Commission's document spreads this co-responsibility rather widely: "Due to their greater economic power, the industrialized countries bear a heavier responsibility, which they must acknowledge and accept." (Politicians are called on specifically to form public opinion in this area).

Groups in authority in indebted countries must be willing "to explain their own actions, errors, and even abuses" and avoid the temptation to "shift full responsibility to other countries" so that they will not have "to propose any changes which would affect them directly." They must also "accept having their actions and any responsibilities they may have in their countries' indebtedness scrutinized (and must)...promote sustained economic growth...in order to ensure a broader and more just distribution among all..."

Though "creditors have rights, acknowledged by the debtors..., creditor States have to find reimbursement conditions which are compatible with each debtor State's ability to meet its basic needs..."

Commercial banks are urged to finance "projects on the basis of their impact on growth in preference to 'safer' projects with more immediate investment returns," even though this approach "goes beyond the traditional function of commercial banks insofar as it invites them to undertake a type of discernment which transcends the ordinary criteria of profitability..."

"Multinational companies have extensive economic, financial and technological power... As economic and financial actors on the international stage, they are called to co-responsibility and solidarity which is above and beyond their own vested interests."

Finally, the multilateral financial organizations "are faced with new and urgent responsibilities: to help solve the debt crisis of the developing countries; to avoid a generalized collapse of the international financial system; to help all peoples, especially those in greatest need, to bring about their own development; to combat the spread of poverty under all its various forms and thereby promote peace by eliminating the threats of conflicts..."

The link which the Vatican document establishes between a just solution of the debt problem and social peace is crucially important. Although the debt crisis has coincided with -- or perhaps even partially caused -- considerable democratization in Latin America during the last few years, as mismanagement by authoritarian ruling groups was revealed, there is a danger that the austerity associated with IMF standby agreements and commercial bank pressure for full repayment may push these fledgling democracies to adopt unpopular polices that could lead to a revival of authoritarianism to enforce the austerity programs. Thus the banks may be pitting themselves, unwittingly, against the very forces in the debtor countries that could provide a democratic, growth-with-equity alternative.

Our discussion here today, as well as much of the analytic material in our pastoral letter, has a dispassionate, even clinical, tone. We hear a different voice in letters from American missionaries overseas, like one that came in recently describing the missionary's return to the mission country after some period of time: "Today I rode the bus downtown, for which I paid 250,000 pesos...When I was here ten years ago, I could have brought the bus for that price."

We also hear a different voice when we meet with Latin American bishops on these issues, we did a year ago in Miami.

The "cool" analysis of the debt problem became immediate, personal, passionate, and urgent when we heard a Brazilian bishop say, for example: "Your debt is an iron ring around the necks of my people." These bishops had two major financial problems on their minds -- the debt, and capital flight. They were very hard on their own political and economic leaders for pushing money out of the country into those attractive overseas investments, but almost equally hard on the industrialized countries for placing those profit temptations in the paths of the elites.

I worry a little about the almost exclusive focus on the debt problem in hearings like this, as well as about the tendency to view it in tandem with the trade problem -- as if to suggest that the main or only reason for relieving the debt burden is to make it possible for the debtor countries to buy our exports. We do not believe the Third World debt problem can be solved without addressing all aspects of the international order. We said in our pastoral letter on the economy that "We believe that U.S. policy toward the developing world should reflect our traditional regard for human rights and our concern for social progress. In economic policy, as we noted in our pastoral letter on nuclear war, the major international economic relationships of aid, trade, finance, and investment are interdependent among themselves and illustrate the range of interdependence issues facing U.S. policy... Each relationship offers us the possibility of substantial positive movement toward increasing social justice in the developing world..."

In the debt area, as with the other three -- trade, aid, and investment -- the problem goes beyond even the system itself. "It afflicts and oppresses large numbers of people who are already severely disadvantaged. That is the scandal: it is the poorest people who suffer most from the austerity measures required when a country seeks the IMF 'seal of approval' which establishes its creditworthiness for a commercial loan (or perhaps an external aid program). It is these same people who suffer most when commodity prices fall, when food cannot be imported or they cannot buy it, and when natural disasters occur. Our commitment to the preferential option for the poor does not permit us to remain silent in these circumstances..."

We are aware that neither of our two pastoral letters prescribes a policy solution to the problems its focuses on. We think that is proper. The virtue of prudence enters the equation as soon as one moves beyond the realm of principle. We see these two letters as inextricably linked; peace is, after all, the fruit of justice. We know that just as what the peace pastoral recommended in a general sense would call for a very different policy than the United States is following today, so would the economic pastoral. But just as one effect of the peace pastoral was to identify the Roman Catholic community with the effort to reverse the arms race and stem the dangerous drift toward nuclear war, one effect of the economic pastoral will, we hope, be to identify the Roman Catholic community with the cause of economic justice -- especially for the poor, both in the United States and in the Third World.

How that objective is to be achieved is, of course, a matter of debate on many issues. One of them -- possibly the most urgent and intransigent -- is the question we are discussing today.

Even though we don't have a formula to propose to you, we would like to suggest several principles which we and many other religious groups believe should underlie a normative approach to a solution to the problem of Third World debt:

1. Responsibility for the solution must be shared in an equitable fashion by both creditors and debtor countries, and the burden must be lifted from the poor.

2. The primary objective of any approach must be to improve the quality of life of the poorest people through restored and equitably shared economic growth, not to preserve the profitability of banks.

3. Criteria for adjustment of each country's debt situation should take into account, among other things, what the money was borrowed for, how it was used, what efforts the debtor country has already made or begun to repay it, and how the debtor nation proposes to stop capital flight.

4. Efforts to resolve the short-term debt problems should be undertaken in close association with a very basic look at the entire international financial system, with a view to systemic changes designed to established more equitable arrangements that can prevent the recurrence of this kind of crisis.

5. Any structural adjustment or other debt-solution package must preserve the basic human rights of the citizens of

the debtor country and the integrity of its government.

6. Any viable solution must recognize and relieve external factors beyond the control of the debtor country that tend to aggravate and perpetuate the burden -- interest rates, commodity prices, trade barriers, budget deficits, etc.

Thank you for your attention.

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